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IN THE SUPREME COURT OF THE STATE OF DELAWARE

DIRECTOR OF REVENUE, Defendant-Below, Appellant/Cross-Appellee v. VERISIGN, INC., Plaintiff-Below, Appellee/Cross-Appellant	No. 18,2021 Court Below: Superior Court of the State of Delaware, C.A. No. N19C-08-093 JRJ

OPENING BRIEF OF APPELLANT DIRECTOR OF REVENUE

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NATURE OF PROCEEDINGS

On October 23, 2018, the Division of Revenue for the State of Delaware (the "Division") issued corporate income tax advisory notices for the 2015 and 2016 taxable years to Verisign, Inc ("Verisign" or "Plaintiff"). Ex. A to Am. Compl., A39. Verisign protested these notices of assessment on December 18, 2018, and on April 9, 2019, the Director of Revenue for the State of Delaware ("Director" or "Defendant") denied Verisign's protest relating to the computation of a net operating loss deduction and issued a notice of determination. Ex. B to Am. Compl., A44. Per this determination, Verisign's tax due for 2015 and 2016 was [redacted] plus penalties and interest, for a total balance due of $[redacted]

On June 10, 2019, Verisign filed a petition with the Tax Appeal Board appealing the Director's assessment, which Verisign removed to the Superior Court on August 8, 2019. Exs. C and D to Am. Compl., A49, A68. Verisign filed its Complaint against the Director of Revenue in Superior Court on August 9, 2019, and then filed an Amended Complaint on March 4, 2020, alleging that the Division's policy with regards to the calculation of a corporate taxpayer's net operating loss violates Delaware's tax code, the Uniformity Clause of the Delaware Constitution, Delaware's Administrative Procedures Act, and the Equal Protection, Due Process, Commerce Clause, and the Foreign Commerce Clause of the United States Constitution. Am. Compl., A25. The Division's net operating loss policy limits a

taxpayer's allowable net operating loss on its state returns to the amount of the loss "computed for purposes of the federal income tax" as reported on the taxpayer's filed federal returns. 30 *Del. C.* § 1903(a). The Director of Revenue answered the Amended Complaint on April 3, 2020, raising the defenses of failure to state a claim upon which relief may be granted and that Delaware law was correctly applied to assess Verisign's state tax liability for each of the tax years at issue. Ans., A71.

The parties filed cross motions for summary judgment based upon stipulated facts, and on December 17, 2020, the Superior Court issued its Opinion (Ex. A) granting Verisign's Motion for Summary Judgment and denying the Director of Revenue's Motion for Summary Judgment. In its Opinion, after finding that the Division's policy with regards to the calculation of a corporate taxpayer's net operating loss is consistent with Delaware statute 30 *Del. C.* § 1903(a) and does not discriminate against interstate commerce in violation of the U.S. Constitution's Commerce Clause, the Superior Court then held that the Division's policy violates the Delaware Constitution's Uniformity Clause under the reasoning of *Burpulis v. Dir. of Revenue*, 498 A.2d 1082 (Del. 1985). Op. at 26. The Superior Court explicitly declined to reach Verisign's arguments under the Foreign Commerce

Clause of the U.S. Constitution, Op. at 25-26 n.127, and did not address any of the other causes of action enumerated in Verisign's Amended Complaint.[1]

The Superior Court subsequently issued a Final Order (Ex. B) dated December 23, 2020 that ordered the Division of Revenue's tax assessment against Verisign be stricken and that Verisign be allowed to carry forward its net operating losses from tax years 2005–2013 and deduct them from its taxable income in the 2015 and 2016 tax years and in subsequent tax years. The Director of Revenue filed its Notice of Appeal in this matter on January 15, 2021.

[1] Plaintiff's Amended Complaint also alleged claims under the Administrative Procedures Act and the Equal Protection and Due Process Clauses of the U.S. Constitution.

SUMMARY OF ARGUMENT

I. The Superior Court erred by holding that, under the reasoning in *Burpulis v. Dir. of Revenue*, 498 A.2d 1082 (Del. 1985), the Division's policy on how to compute a Delaware corporate taxpayer's net operating loss deduction for state tax purposes unconstitutionally divides Delaware corporate taxpayers "into two groups on the basis of their federal filing status (consolidated filers and separate filers) and then applies a limitation to one but not the other" in violation of Delaware's Uniformity Clause, Del. Const. art. VIII, § 1. Op. at 24. All Delaware corporate taxpayers are required to file state corporate income tax returns on a stand-alone basis. 30 *Del. C.* § 1902(a). Pursuant to the authority in 30 *Del. C.* § 1903(a), the Division permits all Delaware corporate taxpayers to claim a net operating loss on their stand-alone state returns not in excess of the amount computed and reported by the taxpayer "for purposes of the federal income tax" on their filed federal return ***irrespective*** of whether the taxpayer elected to compute their federal returns on a stand-alone or consolidated basis. As a result, a taxpayer's maximum allowable net operating loss on its stand-alone state return is exclusively the result of a taxpayer's choice and is not the result of the Division imposing a differential limit on allowable net operating losses or dividing taxpayers "on the basis of their federal filing status." *See* Def.'s Ans. Br. in Opp. to Pl.'s Mot. For Summ. J. at 20-21, A214-215.

II. Having first erroneously found that the Division's net operating loss policy unconstitutionally divides corporate taxpayers based on federal filing status, the Superior Court further erred by holding that because the Division allegedly "acted alone" in establishing the net operating loss policy, the Division could not rely on the "reasonableness of the classification" to meet the requirements of the Uniformity Clause established in *Wilmington Med. Ctr., Inc. v. Bradford*, 382 A.2d 1338, 1344 (Del. 1978). Op. at 25. In Delaware, the legislature specifically authorizes the Division to make any "decision[] not inconsistent with this title . . . necessary to enforce any state tax." 30 *Del. C.* § 354. Thus, by the Superior Court having found that the Division's net operating loss policy is in fact consistent with 30 *Del. C.* § 1903(a), such a policy is authorized by the legislature and any resulting classification regime therefore meets the requirements of the Uniformity Clause if it is reasonable. *Wilmington Med. Ctr.*, 382 A.2d at 1344.

STATEMENT OF FACTS

The stipulated facts before the Superior Court below and submitted in support of this appeal were all derived from a review of Delaware's tax statute, Delaware Division of Revenue's Tax Instructions, and the documents and testimony provided in the underlying litigation. The stipulated facts are as follows:

1. Delaware law requires that each corporation that is not exempt pay a tax on its taxable income derived from business activities carried on and property located within the State during the income year. 30 *Del. C.* § 1902(a). Delaware thus does not allow members of a consolidated group to file consolidated state corporate income tax returns but rather requires that each corporation file state corporate income tax returns as a separate entity. *Id.*

2. The Division provides "[s]tep by step instructions for completing the Delaware corporate income tax return" entitled State of Delaware Income Tax Instructions and Returns ("Tax Instructions"). A169. For 2015 and 2016 the Tax Instructions were identical in all sections relevant to this dispute.[2]

3. The Division requires that a corporate tax filer provide a copy of its filed federal return, inclusive of schedules and exhibits, with its Delaware corporate income tax return. Tax Instructions, A171.

[2] All cites to the Tax Instructions are to the 2015 and 2016 instructions.

4. The stand-alone 'entire net income' of a corporation which is to be entered on Line 1 of the Delaware state income tax return is the "federal taxable income for such year as computed for purposes of the federal income tax." 30 *Del. C.* § 1903(a); Tax Instructions, A171.

5. Delaware law and the Division's Tax Instructions require that a corporation calculate its stand-alone federal taxable income, including all deductions, in accordance with the federal Internal Revenue Code ("IRC"). 30 *Del. C.* § 1901(10); Tax Instructions, A175; Deposition of Eliott Johns, Oct. 1, 2020 ("Johns Dep."), 50:24-51:4, A157-158.

6. The Division and its auditors look solely to the net operating loss calculated by the taxpayer pursuant to the IRC with "no modification to the amount of the net operating loss [] allowed." Tax Instructions, A175; Johns Dep. 26:11- 18, A156; 73:19-74:12, A163-164; 77:2-13, A167.

7. The Division and its auditors do not have insight into the calculation of Verisign or Verisign Group's calculation of its net operating losses under the provisions of the IRC. Deposition of Alison Malloy, Sept. 16, 2020 ("Malloy Dep."), 39:9-40:6, A122-123.

8. The Division's Tax Instructions state that Delaware only recognizes a net operating loss "for Delaware corporate income tax purposes [] to the extent of the amount recognized for Federal purposes" and that "[t]he deduction is calculated in

accordance with the provisions of the Internal Revenue Code, and no modification to the amount of the net operating loss is allowed." Tax Instructions, A175.

9. For members of a consolidated group, the Division compares a Delaware corporation's net operating loss to the net operating loss reported on the filed consolidated federal return in order to confirm that the net operating loss claimed for Delaware corporate income tax purposes does not exceed the amount of the net operating loss that was recognized for federal purposes on the consolidated return. Johns Dep. 21:8-14, A155; 75:24-76:5, A165-166; Tax Instructions, A175.

10. The Division's policy and practice of limiting the net operating loss of a Delaware corporation which is a member of a consolidated group to the net operating loss recognized on the filed consolidated group's federal return has been in place for at least 30 years, and, in any event, longer than any current employee of the Division can remember. Johns Dep. 62:13-63:8, A161-162. In that time, the Division's policy has not been challenged other than the present case. Johns Dep. 59:23-60:11, A159-160.

11. Verisign is not the only corporate taxpayer that has been audited and assessed taxes as a result of the Division's policy and practice of limiting the net operating loss of a Delaware corporation which is a member of a consolidated group to the net operating loss recognized on the consolidated group's federal return as filed. Johns Dep. 59:6-9, A159.

12. When auditing corporate tax returns, it is the policy and practice of the Division to limit the amount of net operating losses that may be claimed by a corporate member of a consolidated group to the amount allowed for the consolidated group in its filed federal tax return. Def.'s Resp. to Interrog. 2, A185.

13. The requirement under Delaware law that a corporation calculate its federal taxable income and deductions, including net operating losses for the consolidated group and on a separate company basis, in accordance with federal law as prescribed by the IRC is independent from, and irrespective of, the manner in which federal law calculates that income or those deductions. 30 *Del. C.* § 1901(10); Tax Instructions, A175.

14. Verisign is a Delaware corporation with its principal place of business at 12061 Bluemont Way, Reston, Virginia 20190. Am. Compl. ¶ 1, A25. Verisign is a member of a consolidated group of companies ("Verisign Group") and elected to participate in Verisign Group's consolidated tax return for federal purposes in 2015 and 2016. Malloy Dep. 59:5-8, A126; 70:8-20, A127.

15. Verisign filed its 2015 Delaware corporate income tax returns with a copy of its 2015 federal consolidated return, inclusive of schedules, in September 2016. A135; A139.

16. Verisign computed its 2015 federal taxable income to be [redacted] and, as shown on the federal 1120 Pro Forma Verisign filed with Delaware, this

calculation reported the amount of Verisign's net operating losses as the amount of net operating losses recognized for federal purposes on Verisign Group's 2015 consolidated returns as required by Delaware's Tax Instructions. A135; Malloy Dep. 42:7-16, A124.

17. Verisign reported its "Federal Taxable Income" of [redacted] on line 1 of its 2015 Delaware corporate income tax return. A136. Verisign claimed additional net operating losses in the amount of [redacted] on line 2(g) of its 2015 Delaware corporate income tax return resulting in [redacted] for 2015 before Delaware specific additions. *Id.*

18. Verisign filed its 2016 Delaware corporate income tax returns with a copy of its 2016 federal consolidated return, inclusive of schedules, in October 2017. A144; A148.

19. Verisign computed its 2016 federal taxable income to be [redacted] and, as shown on the federal 1120 Pro Forma Verisign filed with Delaware, this calculation reported the amount of Verisign's net operating losses as the amount of net operating losses recognized for federal purposes on Verisign Group's 2016 consolidated returns as required by Delaware's Tax Instructions. A144; Malloy Dep. 75:22-76:8, A128-129.

20. Verisign reported its "Federal Taxable Income" of [redacted] on line 1 of its 2016 Delaware corporate income tax return. A145. Verisign claimed an

additional net operating loss in the amount of [redacted] on line 2(g) of its 2016 Delaware corporate income tax return resulting in [redacted] for 2016 before Delaware specific additions. *Id*.

21. Delaware's Tax Instructions limit the loss that may be reported on Line 2(g) of the Delaware corporate income tax return to "the amount of loss carried back for federal tax purposes and disallowed for Delaware tax purposes." Tax Instructions, A169. The additional net operating losses claimed by Verisign on Line 2(g) of its 2015 and 2016 corporate income tax returns did not comply with the Tax Instructions because in both instances the additional amount reported represented losses being carried forward for Delaware tax purposes. A136; A145; Malloy Dep. 44:4-14, A125; 85:11-20, A130.

22. Verisign's Delaware tax returns for 2015 and 2016 report that in both years it owned real and tangible property in Delaware valued [redacted]. A137; A143.

23. On October 23, 2018, the Division of Revenue issued corporate income tax advisory notices for the 2015 and 2016 taxable years to Verisign. Ex. A to Am. Compl., A39. The Division denied the line 2(g) losses taken by Verisign in 2015 and 2016. *Id*.

24. Verisign filed its Complaint against the Director of Revenue in Delaware Superior Court on August 9, 2019, and then filed an Amended Complaint on March 4, 2020, alleging that the Division's policy with regards to the calculation of a corporate taxpayer's net operating loss violates Delaware's tax code, the Uniformity Clause of the Delaware Constitution, Delaware's Administrative Procedures Act, and the Equal Protection, Due Process, Commerce Clause, and the Foreign Commerce Clause of the United States Constitution. Am. Compl., A25.

25. The parties filed cross motions for summary judgment based upon stipulated facts. On December 17, 2020, the Superior Court issued its Opinion (Ex. A) granting Verisign's Motion for Summary Judgment and denying the Director of Revenue's Motion for Summary Judgment, holding that the Division's policy on how to compute a Delaware corporate taxpayer's net operating loss deduction for state tax purposes unconstitutionally creates two classes of taxpayers in violation of Delaware's Uniformity Clause, Del. Const. art. VIII, § 1, and issued a Final Order (Ex. B) dated December 23, 2020 that ordered the Division of Revenue's tax assessment against Verisign be stricken and that Verisign be allowed to carry forward its net operating losses from tax years 2005–2013 and deduct them from its taxable income in the 2015 and 2016 tax years and in subsequent tax years. This timely appeal followed.

ARGUMENT

I. QUESTION PRESENTED

Did the Superior Court err by: (a) holding that, under the reasoning in *Burpulis v. Dir. of Revenue*, 498 A.2d 1082 (Del. 1985), the Division's policy on how to compute a Delaware corporate taxpayer's net operating loss deduction for state tax purposes unconstitutionally divides Delaware corporate taxpayers "into two groups on the basis of their federal filing status (consolidated filers and separate filers) and then applies a limitation to one but not the other" in violation of Delaware's Uniformity Clause, Del. Const. art. VIII, § 1 (Reply Br. in Supp. of Def.'s Mot. for Summ. J. at 11-12, A235-236; Op. at 24); and, (b) further holding that because the Division allegedly "acted alone" in establishing the net operating loss policy, the Division could not rely on the "reasonableness of the classification" to meet the requirements of the Uniformity Clause as established in *Wilmington Med. Ctr.*, 382 A.2d at 1344 (Mem. in Supp. of Def.'s Mot. for Summ. J. at 23-25, A105-107; Reply Br. in Supp. of Def.'s Mot. for Summ. J. at 12-13, A236-237; Op. at 25)?

II. STANDARD AND SCOPE OF REVIEW

The Delaware Supreme Court reviews a trial court's decision to grant summary judgment *de novo*. *In re Krafft-Murphy Co.*, 82 A.3d 696, 702 (Del. 2013). The review is "*de novo*, not deferential, both as to the facts and the law," and the

Court must therefore determine "whether the record shows that there is no genuine, material issue of fact and the moving party is entitled to judgment as a matter of law." *Hercules, Inc. v. AIU Ins. Co.*, 784 A.2d 481, 502 (Del. 2001) (quoting *Williams v. Geier*, 671 A.2d 1368, 1375 (Del. 1996)).

III. MERITS OF ARGUMENT

The Superior Court erroneously applied this Court's decision in *Burpulis* to the facts of the present case and subsequently committed clear legal error by refusing to apply the reasonableness test under Delaware's Uniformity Clause, Del. Const. art. VIII, § 1, as established in *Wilmington Med. Ctr.*, 382 A.2d at 1344. The Division's net operating loss policy is the direct result of the interplay between the plain text of 30 *Del. C.* § 1903(a), which requires all Delaware corporate taxpayers to report on their state tax returns their entire net income "as computed for federal tax purposes," and the requirement that all Delaware corporate taxpayers file single entity returns under 30 *Del. C.* § 1902(a). The Division's policy is faithful to these two statutory requirements and in no way creates two classes of corporate taxpayers under *Burpulis* or any other legal analysis. Moreover, to the extent a classification is created, it is reasonable and therefore constitutional under Delaware's Uniformity Clause. *Wilmington Med. Ctr.*, 382 A.2d at 1344.

A. The Division's Net Operating Loss Policy Literally Implements the Text of Delaware's Tax Code at 30 *Del. C.* §§ 1903(a) and 1902(a)

Under 30 *Del. C.* § 1903(a), "[t]he 'entire net income' of a corporation for any income year means the amount of its federal taxable income for such year as computed for purposes of the federal income tax . . . ." In 1962, the Delaware State Tax Board, recognizing that deductions are not a matter of right, and "[i]n the absence of any provisions specifically authorizing particular deductions," interpreted § 1903(a) to mean that "Delaware law grants only those deductions which are allowable in computing a corporation's Federal taxable income for the particular year." *Cluett, Peabody, & Co. v. Dir. of Revenue*, C.A. No. 83A-JN-4, 1985 Del. Super. LEXIS 1089, at *7 (Del. Super Ct. Jan. 22, 1985) (analyzing Decision of State Tax Board, Docket Nos. 238, 239 (July 27, 1962)). As a result, the Division does not allow a Delaware corporate taxpayer to claim a net operating loss deduction for state tax purposes in excess of the net operating loss deduction computed for, and reported by, that Delaware corporation on its filed federal return. Statement of Facts ("SOF") ¶¶ 6, 8, 9, 12; Tax Instructions, A175; Johns Dep. 21:8-14, A155; 26:11- 18, A156; 73:19-74:12, A163-164; 75:24-76:5, A165-166; 77:2-13, A167; Def.'s Resp. to Interrog. 2, A185.

Both the *Cluett* Court and the Superior Court below specifically approved of the Division's interpretation of 30 *Del. C.* § 1903(a) as embodied in its net operating loss policy despite the fact that the separate entity filing requirement under 30 *Del.*

C. § 1902(a) also requires Delaware corporations to file state corporate income tax returns using their stand-alone federal taxable income as calculated under the IRC.[3] Consequently, the twice judicially approved interpretation of 30 *Del. C*. § 1903(a), when combined with Delaware's stand-alone filing requirement, means that, when reading 30 *Del. C*. § 1903(a) and 30 *Del. C*. § 1902(a) together, a Delaware corporation like Verisign, which elected to file a federal consolidated return in 2015 and 2016, must calculate its separate entity federal taxable income under the IRC for those years **and** is prohibited from claiming a net operating loss deduction on its state return in excess of the net operating loss deduction reported on its federal consolidated returns for those years. *See* Mem. in Supp. of Def.'s Mot. for Summ. J. at 14-15, A96-97.

As the foregoing makes clear, however, the Division's net operating loss policy limits Verisign's allowable net operating loss on its state returns to the amount of that loss "computed for purposes of the federal income tax" because "Delaware law grants only those [discretionary] deductions which are allowable in computing a corporation's Federal taxable income for the particular year." *Cluett*, 1985 Del. Super. LEXIS 1089, at *7. Thus, the Division's policy takes the net operating loss

[3] In addition to finding that the Division's net operating loss policy was consistent with Delaware law, the Superior Court also held that the Division's net operating policy did not violate the Commerce Clause of the U.S. Constitution. Op. at 19.

reported by corporate taxpayers to federal authorities as a singular limit on the allowable discretionary net operating loss deduction for state tax purposes for all Delaware corporate taxpayers irrespective of how the taxpayer computed that loss under the federal rules and even though that taxpayer must report stand-alone corporate income on their Delaware state income tax return. As the *Cluett* Court pointedly noted, any taxpayer concerns regarding the fairness of "the system created by § 1903 and the separate filing requirement . . . [are] more properly addressed to the Legislature." *Id.* at *8.

B. The Division's Net Operating Loss Policy Does Not Create Two Classes of Taxpayers In Violation of the Delaware Constitution's Uniformity Clause Under *Burpulis v. Dir. of Revenue*

Contrary to the Superior Court's finding, neither the Division's net operating loss policy, nor the text of 30 *Del. C.* § 1903(a) in which it is grounded, divides Delaware corporate taxpayers "into two groups on the basis of their federal filing status (consolidated filers and separate filers) and then applies a limitation to one but not the other." Op. at 24. The Superior Court appears to have reached this erroneous conclusion based on a misapplication of this Court's decision in *Burpulis*. There is nothing, however, in *Burpulis* or any other decision of this Court, which supports the Superior Court's analysis.

In contrast to the computation of corporate income for state tax purposes which Delaware law requires be calculated on a stand-alone basis, 30 *Del. C.* §

1902(a), there is no provision of Delaware law specifically providing for the computation of a net operating loss for state tax purposes on a stand-alone basis or, in point of fact, on any basis at all. A net operating loss deduction is an entirely discretionary deduction granted under the authority provided for in 30 *Del. C.* § 1903(a), the text of which limits discretionary deductions to the amount "computed for purposes of the federal income tax." As a result, the Division limits the net operating loss that ***all*** Delaware corporate taxpayers may claim on their state returns to the net operating loss claimed by the taxpayer on their filed federal returns. SOF ¶¶ 6, 8; Tax Instructions, A175; Johns Dep. 26:11- 18, A156; 73:19-74:12, A163-164; 77:2-13, A167. While it is true that under the federal tax regime Delaware corporate taxpayers ***may*** compute their net operating loss on either a stand-alone or consolidated basis, and that this election subsequently determines the maximum net operating loss available to that taxpayer on their stand-alone state returns, this taxpayer election at the federal level is not directed by, informed by, or otherwise related in any way to, the Division's net operating loss policy. As such, *Burpulis* is inapposite to the present dispute.

In *Burpulis*, this Court approved as consistent with Title 30 the Division's denial of the federal two-earner married couple deduction for a Delaware couple who elected to file separate state income tax returns. 498 A.2d at 1086-87. The Court went on to note that "to permit the two-earner married couple deduction in

Delaware would be to introduce inequities in the tax system where none existed before" and therefore disallowing the "deduction for purposes of separate state tax returns, [] preserves uniformity in our tax system, as required by our Constitution and Title 30." *Id*. at 1087. As the *Burpulis* Court explained, allowing the "two-earner married couple deduction in Delaware" would benefit taxpayers "by virtue of their married status while single taxpayers would suffer" because only married individuals can claim the federal deduction and then subsequently use that federal deduction to their advantage on separate state income tax returns. *Id.* In contrast, single individuals can never claim the federal deduction in the first instance and therefore can never use that federal deduction to their advantage on state income tax returns. As an initial matter, Delaware's tax regimes for individual and corporate taxpayers differ in many substantive respects including, for example, the fact that married individuals may elect to file separate returns, but corporate entities are required to file stand-alone returns even if they are a member of a consolidated group. *See* 30 *Del. C.* § 1902(a); SOF ¶ 1. Thus, arguing by analogy to *Burpulis* in this case is dubious at best, but, however viewed, both the net operating loss deduction and the Division's net operating loss policy in the present case are manifestly not analogous to those at issue in *Burpulis*.

First, unlike the two-earner married couple deduction in *Burpulis*, a net operating loss deduction is not a deduction that is exclusively available to

consolidated corporate filers. All corporations may claim a net operating loss for purposes of federal income taxes regardless of whether they elect to file, and therefore compute that loss, on a stand-alone or consolidated basis. And all corporate taxpayers may then also claim a net operating loss on their Delaware state tax returns regardless of whether they elected to compute that loss at the federal level on a stand-alone or consolidated basis. Consequently, unlike in *Burpulis*, the availability of a net operating loss deduction at the federal level, and therefore the ability to claim a net operating loss on a state income tax return, does not turn on "the basis of [a corporate taxpayer's] federal filing status." Op. at 24.

Second, while a taxpayer who elects to file a consolidated federal return may compute and report a net operating loss for federal tax purposes that, depending on the year, is more or less than the net operating loss would have been if computed on a stand-alone basis, the Division's policy does not subject taxpayers to "differential treatment" on the basis of their federal filing status in contravention of this Court's reasoning in *Burpulis*. Op. at 23. The inequality posited and rejected under the Uniformity Clause analysis in *Burpulis* existed because a single person, by definition, cannot claim a federal deduction only available to married people and therefore, unlike married people filing separate state returns, would have been prohibited from claiming a state tax benefit solely because of their marital status. This is not the situation in this case.

Unlike the single individual in *Burpulis*, Verisign is not by dint of any particular characteristic assigned a federal tax filing status from which certain state income tax consequences flow. Verisign's federal tax filing status is entirely a product of Verisign's voluntary election. SOF ¶ 14; Malloy Dep. 59:5-8, A126; 70:8-20, A127. More importantly, the subsequent impact Verisign's election has on the amount of net operating losses it may claim for state tax purposes is not a result of the Division's policy treating taxpayers differently based on their filing status, but instead results, somewhat ironically, from the fact that the Division's policy applies the same net operating loss limit to all corporate taxpayers – their reported federal loss – regardless of any individual taxpayer's federal filing status and without modification to account for the fact that the taxpayer may, as a result of its federal election, have a different state tax filing status. SOF ¶¶ 6, 8; Tax Instructions, A175; Johns Dep. 26:11-18, A156; 73:19-74:12, A163-164; 77:2-13, A167. Properly understood, the Division's policy prohibits allowing some corporate taxpayers to re-compute their net operating loss for state tax purposes using different federal rules than those the taxpayer used to compute their reported federal net operating loss.

Verisign, a sophisticated corporate taxpayer, presumably elects to file consolidated federal returns because that provides significant federal income tax advantages. Having so elected, Verisign is constrained by its choice under the Division's net operating loss policy to report no more than that federally computed

consolidated loss on its stand-alone state tax returns. As the above makes clear, however, unlike the disadvantaged single taxpayer in *Burpulis*, Verisign is not prohibited from claiming a net operating loss computed on a stand-alone basis on its state tax returns because Verisign was prevented from claiming a federal stand-alone net operating loss in the first instance. Nor, contrary to the Superior Court's conclusion, is Verisign prohibited from claiming a net operating loss computed on a stand-alone basis on its state tax returns because the Division applies a different limit to Verisign as compared to other corporations based on their federal filing status. Rather, Verisign is prohibited from claiming a net operating loss computed on a stand-alone basis on its state tax returns because Verisign elected to compute its net operating loss for federal tax purposes on a consolidated basis and, in so electing, determined for itself the maximum allowable net operating loss for state tax purposes. *See* Def.'s Ans. Br. in Opp. to Pl.'s Mot. For Summ. J. at 20-21, A214-215.

To the extent Verisign argues that *Burpulis* stands for the general proposition that unless Delaware corporations are permitted to claim a net operating loss on a stand-alone basis the resulting tax necessarily violates the Uniformity Clause, Verisign is mistaken. At the very most, *Burpulis* can only be read, by analogy, to have held that a deduction which exists exclusively for consolidated/joint filers, which a net operating loss is most certainly not, cannot be claimed when reporting

stand-alone/separate state income. *Burpulis* in no way requires that a taxpayer be permitted to re-compute a federal deduction reported on a consolidated basis for federal income tax purposes on a stand-alone basis for the purposes of claiming that amount as a discretionary deduction on their state income tax returns.

The Division's net operating loss policy uses the same limit for all taxpayers and the fact that taxpayers are free to compute that limit in different ways under federal regulations does not mean that the Division differentially, and therefore unconstitutionally, applies that limit to some taxpayers and not others. The Division has no interest in, and no control over, how a taxpayer computes and reports its federal taxable income to the federal authorities. SOF ¶ 7; Malloy Dep., 39:9-40:6, A122-123. The Division accepts the federal computation of a net operating loss as provided by the taxpayer without modification for purposes of their state corporate income tax returns. SOF ¶ 6; Tax Instructions, A175; Johns Dep. 26:11- 18, A156; 73:19-74:12, A163-164; 77:2-13, A167. The fact that a taxpayer's federal net operating loss may be computed on either a consolidated or stand-alone basis depending on how the taxpayer elects to file federal returns does not convert the Division's net operating loss policy, which universally limits net operating losses for state income tax purposes to the taxpayer's federally computed and reported loss, into a violation of Delaware's Uniformity Clause. The Superior Court's holding to the contrary was in error.

C. To the Extent A Classification is Created By the Division's Net Operating Loss Policy, It Is Constitutional Under Article VIII, § 1

As explained at length above, the Division's net operating loss policy applies the same net operating loss limit to all corporate taxpayers regardless of whether they elect to file as a member of a consolidated group or on a stand-alone basis at the federal level, namely: an amount that may be equal to, but, in every instance, no more than, the amount reported on the taxpayer's federal return. Consequently, the Division's policy does not create two classes of taxpayers; however, to the extent that any classification allegedly results from the Division's net operating loss policy, such classification is the direct result of the plain language of 30 *Del. C.* § 1903(a) and easily meets the test of constitutionality under the Uniformity Clause set forth in *Wilmington Med. Ctr.*, 382 A.2d at 1344.

As this Court has stated, "Article VIII, § 1 simply requires that all taxpayers of the same class residing within the same tax district be treated equally." *Bd. of Assessment Review for New Castle Cnty. v. Stewart*, 378 A.2d 113, 115 (Del. 1977) (citations omitted). "The principle of uniformity applies to all species of taxes" although the bulk of the cases fall into, and the principle has been particularly important in, "the field of real estate taxation." *Id.* This Court has instructed that the Uniformity Clause "should be construed in light of the fundamental principle which it embodies, *viz.* the uniform and equal distribution of the tax burden among the taxpayers upon whom the tax is imposed." *In re Estate of Zoller*, 171 A.2d 375,

379 (Del. 1961). "The test of constitutionality under the tax-uniformity provision of Art. VIII, § 1 is the reasonableness of the classification." *Wilmington Med. Ctr.*, 382 A.2d at 1344 (citation omitted). Moreover, in evaluating the reasonableness of the classification,

> [t]he differences upon which the classification is based need not be great or conspicuous; nor is it necessary that the court perceive the precise legislative reason for the classification, for if any state of facts can reasonably be conceived that would sustain the classification, the existence of that state of facts at the time of the enactment of the law must be assumed.

Conard v. State, 16 A.2d 121, 125 (Del. Super. Ct. 1940).

In Delaware, the legislature specifically authorizes the Secretary of Finance to "make rules, regulations and decisions not inconsistent with this title . . . as the Secretary deems necessary to enforce any state tax." 30 *Del. C.* § 354. As this Court recognized in *Burpulis*, "the General Assembly delegated to the Secretary of Finance the authority to make any necessary adjustments in the tax laws so long as they 'are not inconsistent with [Title 30].'" 498 A.2d at 1085 (citing 30 *Del. C.* § 354). In the present case, the Division's net operating loss policy does not even go so far as to "adjust" the tax laws, rather it specifically enacts the exact language of the tax code at 30 *Del. C.* § 1902(a) and 30 *Del. C.* § 1903(a) and therefore clearly falls within the broad legislative authority delegated to the Secretary of Finance by the General Assembly. The Superior Court's assertion that the Division's net operating loss policy is not entitled to the deferential review for a Uniformity Clause challenge

because the Division "acted alone" in enforcing its net operating loss policy is thus twice flawed. Op. at 25.

First, it is not clear how the Superior Court, following *Cluett* as precedent, could explicitly rely on the language of 30 *Del. C.* § 1903(a) to conclude that the Division's policy is consistent with Title 30, Op. at 16, and also find ten pages later that the Division's net operating policy was the result of it having "acted alone." Op. 25. Second, and more importantly, under this Court's precedent in *Burpulis*, having found that the Division's net operating loss policy was consistent with Title 30, the Superior Court's finding also recognized that the Division's net operating loss policy meets the test under 30 *Del. C.* § 354 to be an authorized exercise of the Secretary of Finance's delegated legislative authority. As such, even under the Superior Court's dubious formulation which exclusively restricts deferential review under the Uniformity Clause to legislative action, the Superior Court erroneously held that the Division's net operating loss policy was not entitled to deference.[4]

This Court has held that "[t]he test of constitutionality under the tax-uniformity provision of Art. VIII, § 1 is the reasonableness of the classification."

[4] The Uniformity Clause exclusively applies to taxes. As a result, only the legislature or the Secretary of Finance are capable of violating this clause and, because any action taken by the Secretary consistent with Title 30 is a valid exercise of delegated legislative authority and any action inconsistent with Title 30 is invalid for reasons other than the Uniformity Clause, the cases analyzing the Uniformity Clause appear to speak only in terms of legislative deference.

Wilmington Med. Ctr., 382 A.2d at 1344 (citation omitted). The "existence of facts to support the classification of the legislature must be assumed if any set of facts can reasonably be conceived which will sustain such classification." *Aetna Casualty & Surety Co. v. Smith*, 131 A.2d 168, 177 (Del. 1957) (citing *Conard*, 16 A.2d at 125). Objectors like Verisign who assert that a tax scheme was enacted in violation of the Uniformity Clause bear the burden to show that the classification is unreasonable. *Conard*, 16 A.2d at 125. Verisign has not, and cannot, meet the burden of showing that the Division's policy creates an "unreasonable" classification and, as the Division explained in its papers below, because there are facts which easily "sustain the classification," the Division's net operating loss policy meets the test of constitutionality for Article VIII, § 1.[5]

As outlined in Defendant's Motion for Summary Judgment, Delaware's policy of limiting the amount of net operating losses to that amount claimed on the federal consolidated return may be easily understood as an attempt to limit (although not prevent) the manipulation and imprecision inherent in stand-alone reporting when a member of a consolidated corporate group files as a separate entity in Delaware. Mem. in Supp. of Def.'s Mot. for Summ. J. at 24-25, A106-107. The

[5] Although not reached by the Superior Court, in addition to not posing a problem under Delaware's Constitution, the Division's net operating loss policy does not in any way violate the Foreign Commerce clause of the U.S. Constitution as urged by Verisign below.

Division's concerns of possible manipulation are especially heightened with regard to the reporting of net operating losses because the net operating loss of each member of the corporate group on a stand-alone basis is not reported to the IRS and therefore not subject to robust auditing oversight by the IRS. As such, the Division's net operating loss policy is amply supported by easily conceived facts demonstrating its reasonableness and, to the extent the policy creates a classification in the first instance, the Superior Court nevertheless erred in finding the policy unconstitutional under Article VIII, § 1.

CONCLUSION

For the foregoing reasons, the Superior Court's determination that the Division's net operating loss policy violates the tax-uniformity provision of Article VIII, § 1 should be reversed, and Verisign should be ordered to pay its outstanding tax assessments for 2015 and 2016.

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