ORAL ARGUMENT - 12/15/94
94-0245
VIRGINIA INDONESIA CO. V. HARRIS CO. APPRAISAL DISTRICT

BURTON: May it please the court. My name is Randy Burton, and I represent Virginia Indonesia Co., or VICO. This case presents this court with the first opportunity that it has had to expressly address that issue which it left expressly reserved in the case of Diamond Shamrock v. Nueces County. And that issue is whether or not goods which are merely in transit through the State of Texas while on their way to a foreign destination are exempt under the import/export clause and the commerce clause of the United States Constitution.

VICO is the operator and agent for an Indonesian joint venture that explores for oil and gas exclusively in Indonesia. This Indonesian joint venture through VICO purchases goods exclusively for the state owned enterprise of the Republic of Indonesia. These goods originate from vendors and are transported directly to an export packer that VICO uses in Harris County. The final destination of these goods is the Republic of Indonesia. The goods are committed to export to a foreign destination from the moment of purchase. The only interruption between the point of origin and the final destination is that time needed at the export packer to perform basic and required export services mainly: inspection; obtaining approval for import to Indonesia; and packing the goods for export. These activities are required by the laws of the Republic of Indonesia to be performed by the country of export. None of the goods are ever used in Texas, nor are they ever detained in Texas for any business purpose or profit. VICO is merely reimbursed for the goods when they arrive in Indonesia. And VICO retains no control to divert the goods to domestic use.

ENOCH: Does VICO at any point in time own those goods for the purpose of using _____ anything else?

BURTON: Justice Enoch it is our position that they have bare legal title. This is a traditional joint oil and gas joint venture where VICO is the operator of that oil and gas joint venture. They acquire goods on behalf of and for the joint venture itself.

ENOCH: But until the goods arrive in Indonesia...VICO buys the goods...

BURTON: For Indonesia.

ENOCH: Well you say for, but VICO actually buys the goods. It does its function of getting them inspected for international transit, and then ships the goods to Indonesia. On arriving in Indonesia, VICO then is paid for those goods. Isn't that how the transaction works?

BURTON: It bills the joint venture and is paid. It is merely reimbursed dollar for dollar. That's correct.

ENOCH: But VICO receives no commission on...where does VICO get its profits if this is just a dollar for dollar pass through?

BURTON: Good question. Like other typical oil and gas joint ventures it has a royalty interest for the operations that are conduct in Indonesia. Those are separate issues. They are an operator, and as operator they perform various functions for this joint venture and are merely reimbursed for those functions. They are also a royalty interest owner based upon the oil and gas that is produced in that

recovery.

ENOCH: Should that pose a problem property tax wise, where someone is in the business of acquiring and selling goods, albeit strictly exporting, that on January 1 owns goods that are on site in the taxing authority. Is that the problem here? Is the issue that VICO actually has ownership in some goods that are in Harris County?

BURTON: I do not believe so. It is certainly an important question. The issue of business activities, an issue that is certainly raised under the commerce clause through the Complete Auto case, which this court appropriately applied in Diamond Shamrock. The issue of business purpose, or business activities is also an issue that comes up in the context of the Xerox case which established an in transit test in the State of Texas. But I think it is important to distinguish for the court that VICO is not in the procuring business. There is actually as part of the competitive bidding process, the country of Indonesia selects through their state owned oil and gas enterprise, a purchasing agent, which may or may not include VICO as the operator. And then that entity goes out and finds the best price that it can around the world for a particular good. This is only one small part of the functions that VICO performs as an operator. It is not by any means in a procuring business. For example, like in the recent El Paso case cited by the appraisal district the Venmar(?) case, that is not our basic business. We make no profit off of procuring these goods. It is merely one of the activities that we have to perform as operator.

CORNYN: These goods are present for inspection and repackaging for as long as 90 days, or more?

BURTON: Typically less than that, possibly more. What I would point out to the court is that those processes are beyond the control of this entity, VICO. Those processes which include: inspection to make sure the goods are conforming when they are received, and are not broken by the export packer; and also inspection by an Indonesian agent hired by the Republic of Indonesia to make sure that the goods comport with their laws before they are exported to that country. All those things are beyond the control of VICO. These goods have been committed from the moment that they were acquired from various vendors to the export process. They are in the export stream, that cannot be diverted by that stream. VICO has no domestic operations where they can sell or reuse these goods. They are merely stopped only so long as is necessary to perform those essential export functions and put them on the next available ship to Indonesia. So it is possible that on some rare occasions some of those goods may be there that long, or possibly even slightly longer. But again those functions are beyond our control.

CORNYN: And that's critical to your argument that these goods be in transit?

BURTON: Absolutely critical. And I would suggest to your honor that this court in Diamond Shamrock still recognized the vitality of the in transit issue, not only under the import/export clause, but also in the context of the commerce clause.

ENOCH: I still have a little problem. Couldn't there be an enterprise that is strictly an exporter who acquires goods, not for domestic resale, but strictly for exporting, and warehouses those goods in Texas. And at that warehouse has the goods inspected, as a part of the service it ,provides does the inspection for international transit and in customs and that sort of thing packs it, bonds it or whatever you do, for shipment out. Is it critical to your...I mean would you say that an exporter is exempt from property taxes because of the in transit doctrine, or is it critical to yours that in VICO's case these goods are precommitted to the export as opposed to simply warehousing them for future sale, although all of the exporting since it is not precommitted to the export is not in transit?

BURTON: I do think that that is critical Justice Enoch. Because I would say that our facts are

much closer if not identical to the latter set of facts that you just discussed. I would argue that goods that are being warehoused like in the case of both Xerox, the early case _____ and in the case of Cosadar v. National Cash Register, that all those involved problems and issues where the court did uphold the tax on those particular goods, because certain business purposes were being performed like warehousing, resale and so forth. And there was also an issue of whether the goods had actually been committed to the export stream, and had begun that first leg. As long as they are in that warehouse and there is an issue as to whether or not they are going to be sold or when they are going to be sold I think that's a problem. It's a problem for that particular legal entity because there can be no issue as to whether or not the goods are in the export stream. And in our case they have been dedicated. There is no question from the moment that they are acquired and in fact on the actual purchase order it says: Destined for Republic of Indonesia. Foreign purchase order. There is no issue that the goods are bound for the Republic Indonesia. They can't be diverted anywhere else or used by VICO or any other related entity.

CORNYN: Is it your contention that the Michelin test does not apply?

BURTON: No, your honor. I think that this court appropriately applied Michelin, and Complete Auto cases, which are the threshold cases in both the import/export, and the commerce clause. I would say however when you apply Michelin to our facts that you come up with a different result. And I think that this court recognized in Michelin when it was discussing that case, that there is a threshold test even under Michelin before you get to the three-part Michelin test. This court in Diamond Shamrock specifically held that when read in context, the Michelin court's qualification that harmony among the states cannot be disturbed clearly applies only to goods in transit through the state to or from another state, and not to goods merely in transit within the only state that they ever enter. And I believe that it endorsed the opinion of Justice Dorsey on the 13th CA, which this court affirmed in Diamond Shamrock, which said if the goods are merely passing through bound for another jurisdiction they are in transit, and are not subject to the local state's taxation. So I think even under Michelin where you get to the 3-part test, that that case discusses, that there has to be a threshold determination of whether the goods are merely in transit through the state. If they are merely in transit through the state and are import and exports, then the goods...I don't even think you get to the Michelin test.

CORNYN: So Michelin doesn't apply if goods are in transit? Richland applies.

BURTON: I would say Richfield, and even the more recent case of Cosadar(?), which discussed the issue of how can you determine if they are truly in transit. And I think that we are also educated by the 3-part test under Xerox, which talks about whether there is a business purpose, if that was the purpose of the stoppage and so forth. So I think that Michelin implies within it sort of a predicate question of whether or not the goods are merely in transit through the state in that case. And the other case Itell(?) which both the 14th CA and the appraisal district have relied upon for the notion that the in transit test has been abandoned for import/export clause purposes neither one of those involved goods in transit. In fact Itel didn't even involve imports or exports.

CORNYN: If I understand your argument the Michelin test applies, but we don't get to the Michelin test because it flunks the Richfield test?

BURTON: I would say that's a correct determination your honor. I would also say that even if it were to apply the Michelin test, then VICO prevails. But under the three part test of the Michelin, the 6 part test under the commerce clause the Japan line and the Complete Auto that we would prevail under all of those tests, and for all those reasons that our goods should be exempt from taxation.

CORNYN: How long would it take for goods to be present here in Harris county for example

before you could say the goods are no longer in transit? You say 3 months isn't too long. Is it a function of time, or is it something else key?

BURTON: I think your honor hit upon it exactly. It is a not a function of time. I do think that certain courts have looked to those kinds of issues. I don't think there is a bright line test in terms of is it 175 days, or something magical like that. I think what the courts have said and particularly the Texas courts have said is that the goods are only temporarily in this state, and even outside of the state's taxing jurisdiction. The Texas Property Tax Code if they are in transit, and I think you have to look at the facts to determine whether or not they are truly in transit before you make that other determination.

Under the commerce clause there are 6 different tests. Four of those are embodied in the Complete Auto case, and have to do with whether there was a substantial nexus between the goods in the state of Texas; whether there was a fair apportionment of the tax on the goods; whether the goods were inherently discriminatory and discriminated against interstate commerce; and whether or not there were state services that were provided by the State of Texas. Again it is our position that under each one of those particular tests, as well as the two tests under Japan Line, that there is no substantial nexus. And I think even in those cases you can see the thread as this court did in its opinion with the in transit issue, which this court said was instructive on the first and fourth prongs of Complete Auto, and that under those circumstances our goods are still exempt.

* * * * * * * * * *

RESPONDENT

WALL: May it please the court. Petitioner's argument this morning has been that the tax levied on its property is invalid, because the property was in transit, both for purposes of the import/export clause, and for purposes of the commerce clause.

Respondent's position on that point is two-fold: first, the goods were not in transit, either for the purposes of the import/export clause, or for the commerce clause; and secondly, even if the goods were in transit, the in transit status of the goods is no longer per se in validation of the tax.

CORNYN: Has the Richfield case been overruled?

WALL: The Richfield case has not been overruled.

CORNYN: And doesn't that second contention of yours run into some conflict or tension with the Richfield decision?

WALL: The court in the Itel case which was decided in 1993, did not overrule Richfield, but it did question its continued validity. And it was not overruled because it was not necessary to in that case, because that case did not involve goods in transit.

CORNYN: So Richfield didn't apply to Itel?

WALL: That is correct your honor. Let's go back if we may to whether these goods were in transit for purposes of the import/export clause assuming that that has any bearing on the case. There are 4 cases that I would like to mention briefly to the court that bears directly on that issue. The first being Richfield, decided as I recall in 1946. In the Richfield Oil case that involved an excise tax or a sales tax on fuel that was delivered on board a foreign vessel. The fuel was sent by pipeline from the Richfield refinery to its tanks at the Los Angeles harbor, where it was held and then pumped directly in to a foreign oil tanker for transport to New Zealand. The moment of taxation was the moment when title passed and

that was when the oil was pumped into the tanker of the ship that was going to carry it abroad. That same issue came up recently in the 5th Circuit in the case of Louisiana Land Exploration Co.. Very similar facts. In that case Alabama levied an excise tax on aviation fuel, and the tax was levied at the moment the fuel entered the tanks or the vessel that would transport it to Nova Scotia. In both of those cases the tax was invalidated on import/export clause grounds. Two other cases, which I would like to mention upheld the tax. The first was the case of _____, which is cited in the briefs. In that case a Columbian company had purchased a cement plant in California. On the tax day only 12% of that plant had been sent to Columbia. The rest of the plant was in various stages of being packed, crated, dismantled. The court upheld the tax on all of the plant that remained in California, because it had not yet entered the export stream. Even though it was committed and title had passed. The Cosadar(?) case also cited in the briefs, the tax was levied on office machines owned by National Cash Register, and in its warehouse in Ohio. Those machines were designed specifically to fulfill foreign purchase orders. They were certain to be exported. None of those machines in the course of that business had ever been exported and returned to the United States. Certainty of export was assured. But the physical movement in the export stream had not begun. Therefore, the tax was sustained.

ENOCH: Is it your position that because VICO became the record holder of the equipment when it arrived in Texas, that that's why this property is not in transit?

WALL: No, your honor.

ENOCH: If Virginia Indonesia had sent out purchase orders to a number of different suppliers to say we are buying the product, ship it to this destination for packing for international shipment, would you be standing here before us today claiming that the property that was there on January 1 was subject to the property tax in Harris county?

WALL: Yes, your honor.

ENOCH: Then why is that not in transit?

WALL: Because it has not yet entered the export stream.

ENOCH: In other words Texas, because it is the ,port can tax all property that comes into that port to be shipped out exporting, because at that point there is no other states for it to pass through before it starts the export stream?

WALL: No, that's not our argument your honor.

ENOCH: Then why if a foreign corporation buys a product in New York, and says ship it through a packer in Houston to my destination; and it arrives in Houston and it is there on January 1, explain to me how that is not in transit?

WALL: It has not yet entered the stream of export.

HECHT: Where does the stream begin?

WALL: I think it begins when it goes to the boat or to a common carrier to take it to the boat your honor. And I think the cases that we have cited support that conclusion. Now to answer your question hopefully Justice Enoch, the situation here is that VICO does something with the goods when they arrive in Harris County. VICO inspects those goods to assure that it got what it bought. This is not a case where VICO walks into a store in Columbus, Ohio, picks out 100 wiggets and says ship these to Texas

to pack to go to Indonesia. VICO orders those. When they come into Harris county VICO determines first that it got what it ordered; it inspects the goods for quality, correctness. All of those things having nothing to do with transit. Now assuming that...and for that reason it is our position that transit was interrupted for that purpose.

CORNYN: If they just had to package them could they still be in transit, or is the inspection...in other words I am trying to figure out if it's the inspection and approval of goods that is critical to your argument?

WALL: I think it is your honor. Assuming that the in transit position still has any validity.

HECHT: So in other words if it were possible to inspect the goods for export in Chicago, and then ship them to Houston and just waylaid them there for however long it took to get them on a boat, they would be in transit or not?

WALL: I would agree your honor, that under prior law, yes, they would be. The continuity of transit would not have been interrupted.

HECHT: So your position really does come down to how much activity surrounds the goods while they are stopped in Houston?

WALL: That is correct. Secondly, however, if I may, our position is further that the in transit rule no longer operates in and of itself to invalidate a tax.

CORNYN: So Richfield has been at least modified if not overruled?

WALL: I would think that is the case your honor. I think that the Supreme Court has applied...in import/export cases the court has held in Itel that two of the three prongs of the Michelin test are incorporated in the Complete Auto, Japan Line test, the third prong being the interference with import revenues. And we don't have that in this case. So if the tax meets the 6 prong of Complete Auto and Japan Line, the tax is valid under the import/export clause and the commerce clause.

CORNYN: Even if the goods are in transit?

WALL: Yes, even if the goods are in transit. Now I think this court correctly noted in your Diamond Shamrock opinion that the in transit status of the goods may have some bearing on whether the four parts of the Complete Auto tests were met, particularly the nexus requirements.

CORNYN: Mr. Wall do we have to lock horns so to speak with the 5th circuit in the Louisiana Land case in order to accept your argument if we conclude that these goods were in transit?

WALL: You do not. Louisiana Land and Richfield are both distinguishable I think on their facts your honor in that the tax was levied at the moment the petroleum product went onto the vessel that was taking it abroad. That is not the case here. We are not talking about property that is sitting on the docks in Harris county waiting to go on ships. We are talking about property that is being inspected, and held, and prepared for export. It has not made that physical movement of going on to the boat, or going to a common carrier to go on a boat.

The in transit rule first appeared in 1872 in a case of state freight tax. The SC in that case invalidated a Pennsylvania tax of freight moving through the state on commerce clause grounds. And the basis for that was that under then current commerce clause jurisprudence states were precluded

from regulating commerce. And the court held that the state tax on goods moving in commerce was a regulation of commerce. That doctrine no longer prevails. States may now tax commerce. Commerce may be made to pay its share of the cost of government. The underlying reason for the in transit rule no longer exists.

The amicus in this case argues that there is a need for a bright line transit rule. And I think that argument has a great deal of merit. But the in transit rule has never been a bright line rule. As shown here today there is a substantial dispute in this case over whether these goods are in transit. The rule always worked when there was no question about whether the goods were in transit. But it was very difficult to apply if that were an issue.

The burden in this case is on the taxpayer to show by clear and _____ evidence that this tax runs afoul of one of the six prongs of the Complete Auto, Japan Line test. The summary judgment proof in this record does not establish that any of those six factors are violated. For that reason respondents ask the court to affirm the decision of the court below.

* * * * * * * * * *

REBUTTAL

BURTON: Your honors. First I would like to talk specifically about and distinguish two of the cases that Mr. Wall discussed: the Impresso(?) case, and the Cosadar(?) case, both of which involved the in transit issue. And to try to distinguish for the court this issue of whether or not inspection, approval, and the amount of activity and so forth actually take goods out of the in transit process. And I also think that the case of Xerox is particularly instructive. But Impresso, which is one of the cases that Mr. Wall cites, is easily distinguished. And the court in that case made a point that the goods had not been delivered to any carrier for export or otherwise started on their journey. And the SC specifically upheld the tax because the properties still might have been diverted into the domestic market and on the day of taxation the movement to foreign shores hadn't been started or committed. Clearly in our case there is no way to divert the goods. The goods are bought for this joint venture. They are on that path from the moment that they are purchased and start on that journey to the export packer in Houston. They have been delivered to an export packer. That step has been started, the journey has been commenced, and there is no way that they can be diverted to the domestic market. We have no domestic market. All we are doing is performing those services that are absolutely necessary to get them on a boat to the Republic of Indonesia. These are services that are performed specifically pursuant to Indonesian law. Obviously they have to be packed. They have to be inspected under Indonesian law. If the goods were not inspected they would be rejected by Indonesia. And these are processes that must be performed by the country of export.

CORNYN: There's no question that your client receives the benefit of police and fire protection for these goods during the 45-90 days or so that they are present there in Harris County is there?

BURTON: I would assert that there is a question. Because I think the issue there is whether they receive direct state services. And I think that the Louisiana Land and some other cases spent some time talking about that particular issue.

CORNYN: What do you mean by direct? There is a call to the warehouse would they come?

BURTON: I would say that anything derivative of the services that are received by the import/export packer. The import/export packer that is temporarily processing our goods on their way to overseas receives these services is taxed through various taxes for the provision of those services. And they also pass a portion of those taxes onto their various users such as VICO, in terms of the fees that they charge us. I think it is under both the nexus, the apportionment, and the discrimination argument as well

as the direct provision of state services that we would have no problem with our goods being liable for additional taxes that we are already paying for services to the import/export packer.

Under Cosadar(?) again this court discussed that...it was the physical movement of the goods into the stream of exportation that was the overriding criteria. And it decided and cited the Spalding Brothers case for the proposition that the delivery of baseballs and bats to an export packer constituted a significant step in exportation. These goods have to go through these processes. This court in Cosadar(?) specifically identified the export packer step of the journey as part of the continuous process that gets the goods to the foreign destination. Again, a distinction that is in VICO's favor.

CORNYN: What if these were component parts that were shipped from various locations in the United States and assembled in Harris county at VICO's warehouse; would that make any difference?

BURTON: I think it would your honor. I think that that kind of process is clearly a business activity or business purpose that could take them out of the protection of the commerce clause. No similar kind of process is performed on these goods. There is no manufacturer, no production, no assembly, the goods are inspected, approved, and packed.