No. 15-1442

IN THE

Supreme Court of the United States

THE GILLETTE COMPANY, ET AL.,

Petitioners,

v.

CALIFORNIA FRANCHISE TAX BOARD,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

BRIEF OF INTERNATIONAL BUSINESS MACHINES CORPORATION, GENERAL MILLS, INC., HEALTH NET, INC., AND S&P GLOBAL INC. AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

MARDIROS H. DAKESSIAN
DAKESSIAN LAW, LTD.
445 S. Figueroa Street,
Suite 2210
Los Angeles, CA 90071

DONALD M. GRISWOLD
Counsel of Record
CROWELL & MORING LLP
1001 Pennsylvania Ave., N.W.
Washington, DC 20004
(202) 624-2500
dgriswold@crowell.com

Counsel for Amici Curiae

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INTEREST OF *AMICI CURIAE*[1]

Amici International Business Machines Corporation ("IBM"), General Mills, Inc., Health Net, Inc. ("Health Net"), and S&P Global Inc. are businesses that pay corporate income tax in many states. IBM successfully challenged Michigan's repudiation of Art. III, § 1 of the Multistate Tax Compact ("Compact"), the same Compact provision that California repudiated in the case that is the subject of this writ. *Int'l Business Machines Corp. v. Dept. of Treasury*, 852 N.W.2d 865 (Mich. 2014). Health Net's similar challenge is currently before the Oregon Supreme Court in its appeal from *Health Net, Inc. v. Or. Dept. of Rev.,* No. TC 5127, 2015 WL 5249431 (Or. Tax Ct. Sept. 9, 2015), *appeal pending*, No. S0603625.

Amici IBM, General Mills, and S&P Global (through its predecessor company McGraw-Hill) are members of the original coalition of companies that brought an industry challenge to the validity of the Compact, culminating in *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978). From the perspective of that case and the controversies of that time, *Amici* write to alert this Court that, should it deny the instant writ, there may be serious

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[1] Pursuant to this Court's Rule 37.2, *Amici* have timely notified the parties of their intent to file an *amicus curiae* brief. The parties have consented. Pursuant to Rule 37.6, *Amici* state that no counsel representing a party authored this brief in whole or in part, and no person or entity other than *Amici* or their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

negative consequences for the health of state tax systems across the country.

REASONS WHY THE WRIT SHOULD BE GRANTED

The ability of Compact party States to repudiate the Compact's central guarantee of uniformity and fairness is challenged by Gillette in the case below. If the lower court's misreading of this Court's precedent is allowed to stand and Compact party States are allowed to breach their obligations without consequence, then the foundation of State tax systems, taxpayer trust, will be compromised.

A. The Court should hear the case because public confidence in tax system integrity will erode if States may repudiate the Compact's core guarantee with impunity.

When it entered into force in 1967, and again a decade later when *Amici* challenged it, the Compact was universally recognized to be a binding contract among those party States.

Unless the Court takes this case, Compact party States will have succeeded in repudiating the Compact's central guarantee of taxpayer fairness and multijurisdictional uniformity, the promise these States made decades ago to reassure taxpayers and public officials that the national interest did not require the federal enactment of multijurisdictional apportionment rules applicable to all States.

If this Court allows the Compact party States today to breach their central contractual obligation with impunity, the result will be a return to widespread public distrust of State promises of fairness to multistate taxpayers. This will be

unhealthy for the nation because public confidence in the fairness of state tax systems lies at the heart of the effectiveness of these essentially voluntary compliance regimes.

1. The uniform apportionment election of Art. III, § 1 is the Compact's central guarantee of fairness.

a. Art. III, § 1 guarantees access to a uniform apportionment method.

The Compact guarantees in section 1 of Article III that, regardless of the effort by any "party State" to increase its taxable share of multistate taxpayers' income by modifying its apportionment rules, taxpayers may always "elect to apportion and allocate in accordance with Article IV" instead.

Article IV's uniform three-factor apportionment formula is taken word-for-word from the Uniform Division of Income for Tax Purposes Act ("UDITPA"), a non-binding model law drafted in 1957 by the Uniform Law Commission. This Court has described that formula as "something of a benchmark against which other apportionment formulas are judged," *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983).

It is this benchmark formula that Petitioner Gillette elected to employ and that the court below allowed the State to repudiate.

b. The Compact's history reveals this access to be its raison d'être.

The roots of the controversy over the Compact's uniform apportionment election go back to this Court's 1959 decision in *Northwestern States*

Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), which surprised the business community with its decision addressing the limits of state taxing powers and inviting them to take their concerns to Congress. Backing up the majority on this point, Justice Frankfurter called in his dissent for federal intervention regarding apportionment – "appropriate standards for dividing up national revenue" – because the "solution to these problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources." *Id.* at 476-477 (*dissent*).

Taxpayers mobilized and Congress responded quickly; before the year was out, it had enacted Pub. L. No. 86-272, 73 STAT 555 (1959) legislatively reversing *Northwestern Cement* and establishing the "Willis Commission" with the central charge to study the problem and to recommend a federal solution.

The Willis Commission's 1964 report recommended comprehensive federal legislation to preempt inconsistent state laws with fair and uniform rules governing state tax nexus and apportionment. *Report of the Special Subcommittee on State Taxation of Interstate Commerce*, H.R. Rep. No. 1480 (88th Cong., 2d Sess. 1964), vol. 1 (the "Willis Report").

Fearing the "Willis bills" that followed in short order after release of that report, and concerned about "the growing likelihood that federal action will curtail seriously existing State and local taxing power if appropriate coordinated action is not taken very soon by the States," the Council of State Governments led an effort that culminated in the 1967 creation of the Multistate Tax Compact. CSG,

The Multistate Tax Compact: Summary and Analysis (1967) (the "CSG Summary") at 1.

Expressing the view that the Willis Report's concerns regarding lack of uniform apportionment rules were either "entirely without foundation" or "much exaggerated," the CSG Summary nevertheless acknowledged it was critically necessary for the States "to assure taxpayers and public officials that multistate machinery exists to cope with any multistate aspects of the State and local tax problem that may arise." *Id.* at 5.

The Compact's primary reassurance addressed the "especially sensitive" issue of apportionment. *Id.* Highlighting apportionment on the opening page of its Summary as "[o]ne of the principal measures for improvements," CSG explained the uniform apportionment election provision of Compact Tit. III, §1 as follows:

> The compact would permit any multistate taxpayer, at his option, to employ the Uniform Act [UDITPA] for allocations and apportionments involving party States or their subdivisions. Each party State could retain its existing division of income provisions, but it would be required to make the Uniform Act available to any taxpayer wishing to use it. Consequently any taxpayer could obtain the benefits of multijurisdictional uniformity whenever he might want it. *Id.* at 1.

In the decade prior to the Compact, unilateral enactments of UDITPA by various States lacked any binding obligation of fidelity to its terms; any State could alter them at will. Consequently, these

enactments had not reassured the public that the risk of double or multiple taxation would thereby be avoided. The Compact, the party States now hoped, would be an entirely different matter. "In all probability the compact can achieve this result in all or nearly all cases merely by helping to make the Uniform Act universally available to multistate taxpayers …." *Id.* at 7.

The Multistate Tax Commission ("Commission") created by the Compact held its first meeting in the summer of 1967, six months after the Compact's introduction and just weeks after it entered into force following enactment by a sufficient number of states.

The minutes of the Commission's first meeting underscore the Compact's raison d'être. Following election of its chair, the business meeting began by thanking a U.S. Senator for "his contribution to the development of the Compact and his leadership in the effort to preserve intact the jurisdiction of the States to tax" and ended by thanking two State Attorneys General for "leading the fight for the Compact and against the Willis bill." Multistate Tax Commission, *Summary of Meeting*, June 15, 1967, Tax Analysts Doc 2016-12152, at 3-4.

These minutes record no dissent from any representative of the party States in attendance when "the Chairman stated his view that the Compact was a legally binding instrument without Congressional consent. Nevertheless, consent legislation has been introduced and will be pressed." *Id.*

Congress never gave its consent to the Compact. While some continued to push for a federal solution

into the 1970s, the assurance provided by inclusion of the Art. III, § 1 uniform apportionment election provision softened public disapproval and, in the end, none of the various Willis bills were passed into law.

c. In the *U.S. Steel* litigation, the States maintained the Compact was binding, not advisory.

A decade after the Compact went into force, *Amici* IBM, General Mills, and S&P Global's predecessor McGraw-Hill joined with U.S. Steel and other large companies operating on a multistate basis in a "U.S. Steel Coalition" to renew the struggle with party States over Compact issues. During that period, the late 1970s, the uniform apportionment election was not their concern for, if there were any State modifications to the Article IV three-factor apportionment formula, they were few and modest. Taxpayers had no significant need to avail themselves of the Art. III, § 1 election.

The U.S. Steel Coalition was concerned about the abusive multistate audits conducted by the Commission that had been created by the Compact. They sued to invalidate the Compact on the ground that it had never been approved by Congress as the Compact Clause appears on its face to require: "No State shall, without the Consent of Congress, enter into any Agreement or Compact with another State, or with a foreign Power …" U.S. Const., Art. I, § 10, cl. 3. As detailed infra, the Compact party States maintained in *U.S. Steel* that their Compact was a legally binding agreement, but they reversed that position in the case below when it no longer suited their financial interests.

This Court concluded that the Compact was immune from the requirement of Congressional approval, applying the federalism test of *Virginia v. Tennessee,* 148 U.S. 503, 519 (1893) that the consent requirement applies only to agreements that are "directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." *U.S. Steel,* 434 U.S. at 471.

d. The uniform apportionment election became relevant in recent years.

Over the following two or three decades, States began to tinker with modifications to UDITPA's apportionment principles. Gradually, the uniform apportionment election of Compact Art. III, § 1 became more than a central reassurance of access to fair and uniform apportionment; the election began to be worth money to some taxpayers, for whom it could produce reduced tax liabilities. As increasing numbers of Compact party States adopted apportionment formulae that diverged ever more from the benchmark Article IV formula, it gradually became apparent that taxpayers and the Compact party States were heading back on a collision course.

The first litigated case challenging a Compact party State's repudiation of the uniform apportionment election was the case below brought by Gillette, whose Petition for a Writ of Certiorari this amicus brief supports.

Shortly before Gillette lost its challenge in the California Supreme Court, *Gillette Co. v. Franchise Tax Bd.*, 363 P.3d 94 (Cal. 2015), amicus IBM won

its uniform apportionment election repudiation case in Michigan, *Int'l Business Machines Corp. v. Dept. of Treas.*, 852 N.W. 2d 865 (Mich. 2014); IBM is now challenging in court the Michigan legislature's response to its victory. Just this week, the Michigan Supreme Court declined to hear a related challenge in *Gillette Comm'l Operations N.A. v. Dep't of Treas.*, 2016 Mich. LEXIS 1155 (Mich. June 24, 2016). The dissent rightly complained that "taxpayers deserve consideration by the highest court of this state" of the issues presented in that case, including whether "the Compact is a reciprocal and binding interstate compact between the signatory states …"

Kimberly-Clark, a fellow Petitioner in the *Gillette* case below, just last week lost its own challenge to Minnesota's repudiation of the Compact's uniform apportionment election. *Kimberly-Clark Corp. v. Comm'r of Rev.*, No. A15-1322, 2016 WL 3474383 (Minn. Jun. 22, 2016).

Other current judicial challenges to State repudiation of the Compact's uniform apportionment election provision include cases brought by amicus Health Net and multistate taxpayer Graphic Packaging. An appeal from *Health Net, Inc. v. Or. Dept. of Rev.,* No. TC 5127, 2015 WL 5249431 (Or. Tax Ct. Sept. 9, 2015), is pending before the Oregon Supreme Court in Docket No. S0603625, and the Texas Supreme Court is considering a petition to review *Graphic Packaging Corp. v. Hegar*, 471 S.W.3d 138 (Tex. App. 2015).

* * *

This short history demonstrates that the guaranteed availability in Compact party States of UDITPA's uniform apportionment methodology

constituted the States' central promise to the taxpayer community that the States would provide a reasonable measure of protection from duplicative taxation. In the case below, California breached that promise, shattering the decades-long uneasy truce between taxpayers and Compact party States on this issue.

2. Public confidence in the integrity of state tax systems will erode if the Court denies the writ.

In April 1961, when the Willis Commission was half way through its work on state taxation, President Kennedy gave a "Special Message" to Congress regarding federal taxation. A concern addressed by the President in that message resonates as deeply today as then:

> One of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment. The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship. … For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous enforcement of these laws.

John F. Kennedy, *Special Message to the Congress on Taxation*, (Apr. 20, 1961), available at http://www.presidency.ucsb.edu/ws/?pid=8074 .

Three years later, the Willis Report echoed the president's concern: The tax system "is dependent upon voluntary compliance by very large numbers of people. Given the taxpayer's well-established prerogative of resolving doubts against liability, the existence of significant areas of vagueness is likely to be broadly reflected in the level of compliance." *Report of the Special Subcommittee on State Taxation of Interstate Commerce*, H.R. Rep. No. 1480 (88th Cong., 2d Sess. 1964), vol. 1 (the "Willis Report"), at 12-13. Uniform apportionment rules, and their availability to multistate taxpayers in whatever State they operate, would be a confidence-building cornerstone of the subsequent Willis bills.

Justice White accurately described the turbulent years following this Court's decision in *Northwestern Cement* as a period of "hostile stalemate" between Congress and the Compact party States, *U.S. Steel*, 434 U.S. at 488 (dissent), but this period was also characterized by a keen awareness that tax regimes are essentially voluntary compliance programs that rely for their effectiveness more on taxpayer perceptions of uniformity and fairness than on audits and penalties.

It appears that taxpayers and public officials backed down when they gained confidence that the party States had legally committed themselves through the Compact to make fair and uniform apportionment available to all taxpayers. The uniform apportionment election provision of Tit. III, § 1 provided adequate assurance so that Congress did not have to act. Amici members of the original U.S. Steel Coalition, like many other taxpayers in the 1970s, took longer to back down, but that chapter closed when this Court spoke in *U.S. Steel*.

The recent spate of repudiations by Compact party States, however, throws us back to that period of uncertainty and lack of faith in the system. The States have forgotten or intentionally breached the central element of the bargain they made with the public when they entered into the Compact. In repudiating the uniform apportionment election, they have impaired the obligation of their own contracts in violation of the Contracts Clause, U.S. Const., art. I, § 10, cl. 1. They should be reminded by this Court that they are legally bound by the Constitution and their own Compact not to do this.

The erosion of public confidence is likely to be significant if the Court declines to hear this case. We urge the Court to restore public confidence by granting the instant writ and confirming that Compact party States cannot repudiate the uniform apportionment election of Compact Art. III, § 1.

B. The Court should hear the case in order to reverse the lower court's misreading of *Northeast Bancorp*.

This matter is also worthy of review because the court below has decided an important federal question in a way that conflicts with this Court's decision in *Northeast Bancorp v. Board of Governors*, 472 U.S. 159 (1985). Specifically, California's high court has determined that the Compact is not binding on the State based on a misreading of *Northeast Bancorp*. In doing so, that court has created a new and incorrect litmus test concerning interstate compacts.

But a resort to history is more important here than innovation. As litigants when this Court last considered the nature of the Multistate Tax

Compact, IBM, General Mills, and S&P hope to offer some historical perspective demonstrating that while recommendations of the Commission were advisory, the Compact itself has always had force and effect. This perspective underscores why the lower court's new rule for determining the nature of a compact is wrong, misconstrues *Northeast Bancorp*, and is inconsistent with the positions taken by the Commission in *U.S. Steel*.

1. The case below conflicts with *Northeast Bancorp*.

In its amicus brief before the court below, the Commission alleged that the Compact lacked the "three 'classic indicia' of a binding compact" citing *Northeast Bancorp*. 2013 WL 7089595, at 8-9. The court below relied on this analysis of *Northeast Bancorp* in its opinion, leading its discussion on whether the Compact is binding by first citing the Commission's view that it is not. *Gillette Co. v. Franchise Tax Bd.,* 363 P.3d 94 (Cal. 2015). It then elevated the "three indicia" to a "test" that is "derived from" *Northeast Bancorp*. *Id.* Such an assertion both misconstrues *Northeast Bancorp* and overstates its importance to this case.

Although *Northeast Bancorp* discussed certain factors in determining that interstate banking legislation was not a binding compact, the court below was wrong to construe those factors as a litmus test to answer whether the Compact was binding or merely advisory. This novel use of *Northeast Bancorp* is inconsistent with the text of the opinion, which does not indicate it was intended to be a determinative test. That is especially true where, as here, the background of the Compact, as

described below, differs so dramatically from that presented in *Northeast Bancorp*.

In *Northeast Bancorp*, this Court found that state banking legislation authorized by federal statute did not amount to an implied compact. 472 U.S. 159, 175-176. In reaching its conclusion, this Court stated that "several of the classic indicia of a Compact are missing"—and proceeded to discuss three such "indicia" in the context of the state legislation based on the record presented. *Id.*

But what this Court did *not* do is more important: (1) it did *not* state that these were the only indicia for determining whether a compact existed; (2) it did *not* decide when a Compact is binding or advisory; and (3) it did *not* deem its discussion of indicia to be a "test" of any kind. So at the Commission's "urging," the court below established an incorrect rule of law and then proceeded to apply it to the taxpayer's detriment in this case, finding that the Compact was not binding.

In stark contrast with *Northeast Bancorp*, one could hardly have imagined from the inception of the Compact up until the current litigation, that any of its party States—let alone the Commission itself—would regard it as non-binding. This is true because of: (1) the historical background and terms of the Compact; (2) the Commission's contemporaneous statements and conduct; and (3) the *U.S. Steel* case. These all indicate that while recommendations of the Commission may have been advisory, the Compact itself was an agreement that had force and effect and could not be nullified by an illusory "test" cited by the Commission in *Northeast Bancorp*, where the very existence of a Compact was in dispute.

2. The Compact's background and terms demonstrate that the Compact is a binding contract.

Regarding the terms and background of the Compact, this Court should be aware of four main points that make inappropriate the lower court's litmus test under *Northeast Bancorp*. They are as follows.

First, the Commission's multistate audit function—a central feature of the Compact contained in Article VIII—was very real and a major objection of many multistate businesses. If taxpayers did not believe that the Compact was binding, they would have ignored Commission audits and assessments, which have continued up until the present time.

In fact, the Commission's nexus program and the $10 million in annual revenue generated were cited in California Assembly Bill 753—the Franchise Tax Board's own failed attempt in 1999 to withdraw from the Compact under Article X, for reasons unrelated to this litigation—as a major reason why withdrawal from the Compact was not a good idea. http://www.leginfo.ca.gov/pub/99-0/bill/asm/ab_0751-0800/ab_753_cfa_19990510_184738_asm_comm.html (last checked on June 27, 2016). Back in 1999, these features were a key part of the discussion that staved off California's Article X withdrawal from the Compact. *Id.*

Second, while AB 753 died in committee, the Franchise Tax Board—citing an opinion from the Attorney General—stated in its legislative bill analysis of AB 753, that repealing the Compact under Article X would be the only way to avoid its future obligations.

https://www.ftb.ca.gov/archive/law/legis/99_00bills/AB753_022499.PDF, p.3 (last checked on June 27, 2016). More recently, while this litigation was pending, California did purport to withdraw from the Compact by repealing its terms. http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_1001-1050/sb_1015_bill_20120627_chaptered.html (last checked on June 27, 2016). And in response to related tax litigation involving amicus IBM, the Michigan Legislature (retroactively) repealed the Compact. 2014 PA 282. This shows that the parties to the Compact did not consider it advisory.

Third, in the very first Commission meeting held in 1967, the Commission's Chair "[s]tated his view that the Compact was a legally binding instrument without Congressional consent." Multistate Tax Commission, *Summary of Meeting*, June 15, 1967, Tax Analysts Doc 2016-12152, at 3-4. This is the exact opposite of what the Commission argues today—that the Compact itself is not binding. We respectfully submit that the comments of the Commission's Chair, contemporaneous to the adoption of the Compact, are more reflective of its nature than positions taken by the Commission when facing the existential threat posed by the current litigation.

Fourth, the Commission's litigating position in *U.S. Steel* was based on its understanding that the Compact was indeed a binding agreement that could be repudiated only by withdrawing entirely from the Compact pursuant to Article X. The Compact was not subject to the Compact Clause, the Commission argued, precisely *because* of the Article X withdrawal position: "Any state is free to join or withdraw from the Compact at will, as exemplified by the

withdrawal of Illinois." 1977 WL 189138 at 44. Amici members of the U.S. Steel Coalition also proceeded in *U.S. Steel* on that basis. Today, the Commission argues to support California's position in this case—all the while knowing that California did not formally withdraw from the Compact until years after the tax periods at issue in the case. Furthermore, there would have been no need to litigate *U.S. Steel* had the Compact been lacking any legal force. Taxpayers simply could have ignored the audits conducted by the Commission.

For the reasons discussed above, the court below erred when it created an imaginary litmus test not found in *Northeast Bancorp* to determine whether the Compact is binding or advisory. The lower court's misunderstanding of this Court's decision is grounds for review. For this reason as well, the writ should be granted.

CONCLUSION

Amici respectfully maintain that the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

MARDIROS H. DAKESSIAN
DAKESSIAN LAW, LTD.
445 S. Figueroa Street,
Suite 2210
Los Angeles, CA 90071

DONALD M. GRISWOLD
Counsel of Record
CROWELL & MORING LLP
1001 Pennsylvania Ave., N.W.
Washington, DC 20004
(202) 624-2500
dgriswold@crowell.com

Counsel for Amici Curiae

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