No. 15-1442

IN THE

Supreme Court of the United States

THE GILLETTE COMPANY, THE PROCTER & GAMBLE MANUFACTURING COMPANY, KIMBERLY-CLARK WORLDWIDE, INC., AND SIGMA-ALDRICH, INC.,

Petitioners,

v.

CALIFORNIA FRANCHISE TAX BOARD,

Respondent.

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

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BRIEF FOR TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF FOR TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

STATEMENT OF INTEREST

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. ("TEI" or the "Institute") submits this brief as *amicus curiae* in support of the Petition for a Writ of Certiorari.[1] TEI is a voluntary,

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[1] All parties received at least 10 days notice of TEI's intention to file this brief, and the brief is filed with the consent of all parties. No party or counsel for a party authored this brief in

nonprofit association of business executives, managers, and administrators responsible for the tax affairs of their employers.[2] The Institute is dedicated to developing sound tax policy, promoting the uniform and equitable enforcement of tax laws, reducing the costs and burdens of tax administration and compliance to the benefit of the government and taxpayers, and defending the constitutional rights of taxpayers.

TEI's members represent a broad cross section of the business community. As individuals who must contend daily with the interpretation and administration of the Nation's tax laws, TEI and its members have much at stake to ensure the tax system is fair, administrable, and efficient. This need is particularly profound in the area of state and local taxation, where taxpayers must navigate the myriad of state tax statutes, regulations, and ordinances that affect their businesses.

The California Supreme Court's decision in *The Gillette Company v. Franchise Tax Board*, 62 Cal. 4th 468 (2015) ("*Gillette*"), allows States that entered into the Multistate Tax Compact ("Compact") to unilaterally revoke their obligation to allow taxpayers to apportion their income using the Compact's equally-weighted, three factor apportionment formula. By doing so, *Gillette* demotes the Compact from a proactive solution enacted by States to forestall federal legislation in the 1960s and 1970s to an ineffective

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whole or in part. No party, counsel for a party, or person other than TEI, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

[2] TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code (26 U.S.C.).

model law that permits States to double tax multistate businesses and disadvantage out-of-state taxpayers.

The California Supreme Court's decision threatens to return multistate taxpayers to the state of inconsistency and uncertainty that existed prior to the enactment of the Compact in 1967. TEI thus has a vital interest in the proper disposition of this case and urges this Court to grant the Petition for a Writ of Certiorari.

SUMMARY OF REASONS FOR GRANTING THE PETITION

In the 1960s and 1970s, States persuaded Congress and the business community that then-imminent federal legislation mandating uniformity in state taxation was unnecessary because a number of States had enacted the Compact. The Compact is a complex interstate agreement, the most central provision of which entitles taxpayers to divide their income among States for tax purposes using either the State's apportionment formula or the Compact's equally-weighted, three factor apportionment formula. The Compact thus offers taxpayers the opportunity to achieve apportionment uniformity, ensuring multistate taxpayers will not be subject to double taxation caused by inconsistent state apportionment methodologies.

California, as well as several other Compact member States, now claim the Compact is a model law rather than a binding agreement. Such States have sought to unilaterally eliminate taxpayers' right to use the Compact's apportionment formula without collectively agreeing to amend the Compact's terms or individually withdrawing from the Compact. California's and other States' attempt to deny this right to

taxpayers violates the Contract Clause of the U.S. Constitution because it impairs the most central provision of this interstate contract. U.S. Const., Art. I, § 10, cl. 1.

The California Supreme Court's determination that the Compact is not a binding agreement is directly contrary to the terms and purpose of the Compact and undermines fundamental principles of tax policy and administration. States that entered into the Compact are entitled to collectively amend the Compact or withdraw from the agreement entirely; however, they must comply with the Compact's terms and honor the commitments made pursuant to that agreement unless and until they take such action.

REASONS FOR GRANTING THE PETITION

I. States Enacted the Compact to Forestall Federal Legislation Mandating Uniformity for Multistate Taxpayers.

The National Tax Association began studying the lack of uniformity among state tax systems and its implication for businesses in the 1920s. Arthur D. Jr. Lynn, *The Uniform Division of Income for Income Tax Purposes Act*, Ohio State Law Journal, Vol 19, No. 1 (1958) 41-53. However, the need for uniformity among state corporate taxes became particularly evident in the 1950s, when more than 35 States imposed direct net income taxes on corporations and businesses that were actively expanding their operations across state lines. *See, e.g., Northwestern States Portland Cement Company v. State of Minnesota*, 358 U.S. 450, 452 (1959); Thomas S. Miller, *Taxation of Interstate Commerce*, The Tax Executive, Vol. 26, No. 1 (1973) 81-82.

The National Conference of Commissioners on Uniform State Laws ("NCCUSL") thus adopted a model law called the "Uniform Division of Income for Tax Purposes Act" ("UDITPA") in 1957. UDITPA provided a uniform method for dividing taxpayers' income between States which, if adopted by all States, would assure multistate taxpayers would not be subject to double tax on their net income. Specifically, UDITPA separates a corporation's income into "business income," which is divided among taxing States using an equally-weighted, three factor apportionment formula taking into account the taxpayer's property, sales and payroll in the state, and "non-business income," which is taxed by a single State according to specified rules. Although UDITPA's methodology was generally regarded as fair and reasonable, "States had scant motive to enact a uniform apportionment scheme benefiting multistate corporations" and UDITPA was not widely adopted as an independent model law. *Gillette*, 62 Cal. 4th at 473.

The climate changed shortly thereafter, however, and States were given the incentive to proactively address uniformity. Two years after UDITPA was adopted, this Court decided *Northwestern States Portland Cement*, 358 U.S. 450. The Court acknowledged that inconsistency among state taxes could subject multistate businesses to double taxation. *Id*. at 462. The Court, however, analyzed the constitutionality of the taxes at issue on an individual basis and concluded a state tax was constitutional if the tax was limited to activities having nexus with the taxing State, did not discriminate against interstate commerce, and was properly apportioned. *Id*. at 452.

Northwestern States Portland Cement intensified the business community's concerns about the lack of

uniformity in state taxation and the potential for double taxation. The business community thus urged Congress to enact federal legislation limiting a State's ability to tax income earned in interstate commerce. Congress passed Public Law 86-272, 15 U.S.C. 381-84 (1959), shortly thereafter. Public Law 86-272 shields a taxpayer from a State's corporate income tax if the taxpayer's only presence within the state is the solicitation of sales of tangible personal property.

Congress also authorized an in-depth study on the taxation of interstate commerce, culminating in the *State Taxation of Interstate Commerce*, 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"). The authors of the Willis Report concluded that the state taxation of interstate commerce was inefficient, inequitable, and varied substantially among States, and recommended that Congress pass federal legislation to resolve the problem.

Congress responded to the Willis Report by introducing a series of bills to accomplish that aim. *See, e.g.*, H.R. 11798, 89th Cong., 2nd Sess. (1965); H.R. Rep. No. 16491, 89th Cong., 2nd Sess. (1966). These bills addressed a wide variety of issues, including increased restrictions on States' ability to subject multistate taxpayers to taxation; expanding the protections offered under Public Law 86-272 to capital stock, gross receipts, and sales and use taxes; and establishing a uniform methodology for allocating and apportioning income among States. *Id*.

The States vigorously opposed the proposed federal legislation as impeding State sovereignty and harming State revenue. For example, the National Association of Attorneys General claimed such legislation

would "have an extremely dangerous effect on the present and future revenue-raising capacities of state and local governments." Multistate Tax Com., First Annual Rep., Period Ending Dec. 31, 1968, pp. 1-2.

The prospect of such federal legislation caused the National Association of Tax Administrators ("NATA") to begin work on an interstate compact to resolve these matters without Congressional interference. *Id.* As stated by Bernard F. Nossel, then Secretary of NATA, the task was to "oppose [H.R. 11798] in a constructive manner and to suggest workable alternatives which would eliminate the need for the kind of congressional action embodied in this bill." *Id.*

NATA presented the finalized interstate compact to States in January 1967. Article IV of the Compact incorporated UDITPA's allocation and apportionment provisions. Article III granted taxpayers the option to "elect to apportion and allocate [their] income in the manner provided by the laws of [an individual] State[]" <u>or</u> "in accordance with Article IV." Art. III, § 1. Thus, the Compact provided member States the freedom to enact their own apportionment rules, encouraging the development of in-state business, while simultaneously entitling taxpayers to apportion their income using the Compact's equally-weighted, three factor apportionment formula. Pursuant to its terms, the Compact became effective and established the Multistate Tax Commission ("MTC") when the seventh State enacted the Compact into law on August 4, 1967. Compact, Art. X, § 1; Multistate Tax Com., First Annual Rep., Period Ending Dec. 31, 1968.

Federal legislation mandating uniformity in state taxation remained a threat even after the first group of States adopted the Compact. The MTC thus declared in its First Annual Report that States needed

to collectively demonstrate their commitment to a uniform solution to avoid federal legislation mandating the same:

> The year 1969 may well be the year of decision. Unquestionably it will test whether the Compact, as an effort by the states to join together in providing an affirmative, collective, and continuing answer and alternative to proposed Willis-type legislation, will have the chance to succeed. This is the year which will tell whether the states will have an opportunity to demonstrate that through the Compact and the Multistate Tax Commission they are willing and able to meet the problems and legitimate complaints of multistate businesses.
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> * * *
>
> So, as the Commission's first Acting Secretary, Charles F. Schwan, Jr., has stated, this is now "put up or shut up" time for the states. Clearly, it is not going to be enough to be opposed to federal legislation. . . .
>
> [W]e know that in order to make a convincing case that states have the vision and energy to make the Compact a workable alternative to federal legislation, it is essential that the Compact be enacted by a great many more states . . . . Only in this way can state officials demonstrate that they have the initiative, commitment, and capacity to carry out coordinated programs which will provide uniformity, simplicity, and equity in state taxation. The hour for this is now.

Multistate Tax Com., First Annual Rep., at pp. 10-11. As the MTC's report makes clear, it was necessary for a majority of States to evidence their commitment to uniformity to successfully stave off federal legislation.

II. The California Supreme Court's Decision Is Inconsistent with the Terms of the Compact, its Purpose, and its History.

California became a member of the Compact in 1974, when it incorporated the full text of the Compact into former section 38006 of the California Revenue and Taxation Code and enacted that provision into law. *Gillette*, 62 Cal. 4th at 473. California had previously codified UDITPA's allocation and apportionment provisions in section 25120 of the California Revenue and Taxation Code *et seq.* Thus, California already permitted taxpayers to apportion their income using the equally-weighted, three factor apportionment formula when it adopted and entered into the Compact.

In 1993, the California Legislature amended section 25128(a) of the California Revenue and Taxation Code and changed the Code's apportionment formula to one that double-weighted the sales factor. The amendment also eliminated taxpayers' right to apportion their income using the Compact's apportionment formula. The Legislature, however, left the equally-weighted, three factor apportionment provision in section 38006 (which contained the Compact) intact and did not withdraw California from the Compact "by enacting a statute repealing the same," as the Compact's terms require. Compact, Art. X, § 2; 80 Ops. Cal. Atty. Gen. 213 (1997) (California Attorney General Opinion confirming "[t]he only way for California to withdraw from Commission membership would be for the Legislature to repeal the statute

enacting the Compact."). In other words, California left the Compact in its statutes and continued as a member of the Compact, but sought to unilaterally override the provision of the Compact granting taxpayers the right to apportion their income using the Compact's equally-weighted, three factor apportionment formula.

Taxpayers contested California's attempt to eliminate their right to apportion their income using the Compact's formula. The California Court of Appeals agreed with taxpayers that the Compact was a "binding, multistate agreement [that] obligates member states to offer its multistate taxpayers the option of using either the Compact's three-factor formula . . . or the state's own alternative apportionment formula" and that this provision was "one of the Compact's key mandatory provisions designed to secure a baseline level of uniformity in state income tax systems, a central purpose of the agreement." *The Gillette Company v. Franchise Tax Bd.*, 147 Cal. Rptr. 3d 603, 606 (2012), *rev'd* at 62 Cal. 4th 468 (2015). However, California Supreme Court reversed and concluded the Compact was "more akin to the adoption of a model law rather than the creation of any mutual obligations among Compact members." *Gillette*, 62 Cal. 4th at 479.

The California Supreme Court's conclusion ignores the Compact's terms, undermines its primary purpose, and allows member States to renege on the representations and commitments made to each other, Congress, and the business community. California's amendment of section 25128(a) thus violates the Contract Clause of the U.S. Constitution because it impairs this interstate contract. U.S. Const., Art. I, § 10, cl. 1.

A. The Compact Is a Binding Agreement.

"Interstate compacts are construed as contracts under the principles of contract law." *Tarrant Regional Water Dist. v. Herrmann*, 133 S. Ct. 2120, 2130 (2013) (citing *Texas v. New Mexico*, 482 U.S. 124, 128 (1987)). "[A]s with any contract, we begin by examining the express terms of the Compact as the best indication of the intent of the parties." *Tarrant*, 133 S.Ct. at 2130 (citing *Montana v. Wyoming*, 131 S.Ct. 1765, 1771–1772, and n. 4, 1778 (2011) and Restatement (Second) of Contracts § 203(b) (1979)).

As stated by the Court of Appeals in this case:

> The contractual nature of a compact is demonstrated by its adoption: "There is an offer (a proposal to enact virtually verbatim statutes by each member state), an acceptance (enactment of the statutes by the member states), and consideration (the settlement of a dispute, creation of an association, or some mechanism to address an issue of mutual interest.)"

Id. at 612 (citing Caroline N. Broun, The Evolving Use and the Changing Role of Interstate Compacts (ABA 2006) § 1.2.2, p. 18).

The Compact fits squarely within this definition. The Compact "enters into force when enacted into law by any seven States" and "shall become effective as to any other State upon its enactment thereof." Compact, Art. X. Moreover, the Compact requires each State to offer taxpayers an election to apportion their income using the Compact's apportionment formula, thus promoting uniformity. Compact, Art. IV. This central provision of the Compact was key to

convincing Congress and the business community that a federal legislative solution was unnecessary.

The Compact's terms are mandatory, not optional. The Compact does not allow States to selectively revoke certain provisions of the Compact. Rather, it requires taxpayers to withdraw from the Compact "by enacting a statute repealing the same." Compact, Art. X, § 2. There would be no need for a withdrawal provision if member States could amend or revoke the provisions at will. Nor is this a fortuitous result. Allowing States to selectively revoke provisions of the Compact would have undermined States' necessary commitment to uniformity to forestall federal legislation.

In sum, the Compact must stand as written unless and until member States affirmatively agree to amend its terms, at which time Congress and the business community can react accordingly. States may choose whether or not to be a party to the Compact but, once they are, they cannot pretend to comply while opting out of select provisions.

B. California's Unilateral Revocation of the Compact's Apportionment Election Provision Is Inconsistent with the Compact's Purposes and History.

The California Supreme Court erred when it suggested the effectiveness of the Compact was not undermined by its determination that the Compact was not a binding agreement. *Gillette*, 62 Cal. 4th at 478. To the contrary, allowing member States to unilaterally eliminate the apportionment election is directly contrary to the express purposes of the Compact, which are to:

> (1) Facilitate the proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes, (2) [p]romote uniformity or compatibility in significant components of tax systems, (3) [f]acilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration, and (4) [a]void duplicative taxation.

Compact, Art. I. Treating the Compact as a model law and allowing member States to unilaterally revoke the apportionment election undermines the equitable determination of a taxpayer's liability, eliminates uniformity, complicates the completion of a taxpayer's return, and potentially results in double taxation.

The California Supreme Court's determination also cannot be reconciled with the MTC's own contemporaneous position and the context in which the Compact was enacted. At the MTC's first organizational meeting, the MTC's Chairman, George Kinnear, stated his view that the Compact was a "legally binding instrument" without Congressional consent. Multistate Tax Com., Summary of Meeting, Jun. 15, 1967. Moreover, the MTC's First Annual Report describes the Compact as an "affirmative, collective, and continuing answer and alternative" to the uniformity legislation Congress was considering.

States were compelled to offer a meaningful solution to the myriad of problems presented by non-uniform state taxation; if they did not demonstrate a real commitment to uniformity, the business community would have pressured Congress to act. Thus, the California Supreme Court's determination that the

Compact was "more akin to a model law" cannot be squared with the Compact's history.

III. The Compact's Apportionment Election Reflects Sound Tax Policy.

The Compact's drafters and member States recognized that the Compact's apportionment election reflects sound tax policy. The Compact's equally-weighted, three factor formula is generally regarded as fair and reasonable. The Compact's election allows member States to tailor their apportionment to incentivize in-state investment without doing so at the expense of out-of-state businesses. Uniformity promotes tax efficiency and ensures that multistate taxpayers will not be subject to double taxation, all laudable goals.

More important, however, sound tax policy requires taxing authorities and taxpayers alike to operate with integrity and transparency. The Compact was a proactive solution chosen by States to forestall Congress from enacting preemptive federal legislation in the 1960s and 1970s. It enabled the States to preserve their sovereignty while defining a mechanism to apportion corporate income for tax purposes. States knew the solution they proposed to Congress and the business community must be more consequential than merely a model law.

Allowing States to renege on their representations to Congress and their commitment to taxpayers undermines the collaboration of tax authorities and taxpayers. The Compact enables member States to fully withdraw from the Compact if they are no longer willing or able to meet the commitments they have made; moreover, member States may always join together to amend the Compact itself if the Compact

no longer serves their collective purpose. Member States, however, have an obligation to honor the commitments they have made unless and until they take such action.

"Men must turn square corners when they deal with the Government," *Rock Island, A. & L.R. Co. v. United States*, 254 U.S. 141, 143 (1920), and "it is hard to see why the government should not be held to a like standard of rectangular rectitude when dealing with its citizens," *Title Ins. Co. v. State Bd. of Equalization*, 4 Cal. 4th 715, 730 (1992) (citing Annot., Estoppel of State or Local Government in Tax Matters (1983) 21 A.L.R.4th 573, 658; Comment, *Hobson's Choice and Similar Practices in Federal Taxation* (1935) 48 Harv. L.Rev. 1281, internal quotations omitted.). Failure to hold member States to this standard will not only undermine any future efforts to reach agreements on interstate taxation short of federal legislation but also threaten to return multistate taxpayers to the era of inconsistency and uncertainty that existed prior to the enactment of the Compact.

Finally, although the Petition specifically addresses California's attempt to disallow the Compact's apportionment election, litigation is progressing in other States (including Texas, Oregon, Michigan, and Minnesota). *See Graphic Pckg. Corp. v. Hegar*; No. 15-0669, Tx. Sup.Ct. (appeal pending); *Health Net Inc. v. Dep't of Revenue*; No. S063625, Or. Sup. Ct. (appeal pending); *Kimberly-Clark Corp. & Subs. v. Com. of Revenue*, No. A15-1322, Min. Sup. Ct. (Jun. 22, 2016); *International Business Machines Corp. v. Department of Treasury*, 496 Mich. 642 (2014); *Gillette Commercial Ops. N. Am. & Subs. v. Dep't of Treasury*, 312 Mich. App. 394 (2015) (appl. for leave to appeal denied). Like California, these States adopted the Compact and

have since sought to revoke its apportionment election without complying with the Compact's mandatory withdrawal provision. The Court's conclusions regarding the nature of the Compact will be instructive, if not determinative, in these cases as well.

The need for this Court's review is particularly apparent in light of the MTC's recent assertion that the taxpayers who are parties to the California litigation will be collaterally estopped from pursuing their claims in other states and those cases will become "functionally moot." *See*, *e.g.*, Amy Hamilton, *MTC Counsel Predicts U.S. Supreme Court Won't Take* Gillette, State Tax Today (May 26, 2016). Although the merits of the MTC's position are questionable, the position further weighs in favor of this Court granting the Petition. A decision from this Court in this case will provide the most fair, equitable, and efficient resolution to the matter and ensure that all taxpayers' claims are handled consistently.

CONCLUSION

For the foregoing reasons, TEI urges this Court to grant the taxpayers' petition for a writ of certiorari.

Respectfully submitted,

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