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Apportionment

In this article, Marty Dakessian of Dakessian Law and Don Griswold of Crowell & Moring discuss the Gillette case from the perspective of the amici in Gillette's petition for certiorari to the U.S. Supreme Court.

Gillette: The Case for Review by Those Who Challenged the Compact Four Decades Ago



BY MARTY DAKESSIAN AND DON GRISWOLD

Introduction

The time has come for the United States Supreme Court to determine whether states who are parties to the Multistate Tax Compact (compact) can repudiate with impunity their obligation to provide taxpayers the option of apportioning their income using the method afforded to them in the compact.

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Gillette's attempt to enforce the compact's apportionment election has received much attention since the beginning of its important litigation in California. In essence, Gillette has correctly tried to avail itself of the standard, three-factor apportionment formula—consisting of equally weighted property, payroll, and sales—that is at the heart of the compact, of which California was (and perhaps still is) a member. The Franchise Tax Board, on the other hand, has wrongly argued that Gillette was required to use the state's modified formula, double-weighting the sales factor, “notwithstanding” California's compact membership.

After winning at the court of appeal, Gillette's fortunes swiftly changed before the California Supreme Court, which—perhaps sensing the substantial impact to the fisc and the disruptive effect upon the status quo—ruled that California was not bound by the terms of the compact. Gillette's bid for review before the U.S. Supreme Court has continued to garner interest from friend and foe alike. Several non-parties have weighed in as friends of the court, each with their own reasons as to why the high court should or should not review the California Supreme Court's decision.

The authors represented International Business Machines Corporation (IBM),¹ General Mills, Inc., S&P Global Inc., and HealthNet, Inc.² as amicus curiae in

¹ IBM has an especially keen interest in these matters, given its successful challenge to Michigan's repudiation of Art. III, § 1 of the 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).

² HealthNet is pursuing a judicial challenge to Oregon's similar repudiation of its compact uniform apportionment

support of Gillette's petition for certiorari.³ All of these entities are multistate corporate taxpayers. And with one exception, these amici were part of the original coalition of companies that brought an industry challenge to the validity of the compact in *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978). In that case, the Supreme Court held the compact valid, so these amici now ask the Court to hold it enforceable. The companies wrote to alert the high court to the "serious negative consequences for the health of state tax systems across the country," should the Court deny Gillette's writ request. The following is a summary of the case for review from the perspective of these amici.

1. Allowing Breach of Compact Threatens Public Confidence in Tax Systems

Amici urged the Court to consider the impact upon public confidence in our voluntary compliance taxing systems should a state be permitted to ignore without consequence the election formula, widely considered to be the compact's core guarantee of apportionment fairness and uniformity. In their brief, the companies recalled the history of the compact and its reason for existence—a move toward multijurisdictional uniformity, when taxing authorities were under threat of federal pre-emption.

The discussion then turned to why the compact's three-factor formula was both a guarantee to taxpayers and the benchmark for fair apportionment sanctioned by the Supreme Court itself. Amici then recounted the events leading up to the promulgation of the compact and its three-factor formula, most notably the Supreme Court's own 1959 decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, which addressed the limits of state taxing powers followed by the passage of Public Law 86-272 and the 1964 "Willis Report," which recommended federal preemption to ensure uniformity in multistate nexus and apportionment rules.⁴ They then described state government efforts to ward off preemption, culminating in the 1967 creation of the Multistate Tax Compact, and noted that the three-factor formula was not an afterthought. Rather, this standard formula was central to state-level efforts to avoid federal action, and was the very heart of the compact itself:

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

election obligation. *Health Net, Inc. v. Oregon Dep't of Rev.*, No. S 0603625 is pending before the Oregon Supreme Court.

³ Portions of this article quote, without use of quotation marks, from the June 30, 2016 amicus brief co-authored by Messrs. Dakessian and Griswold in support of Gillette's cert petition.

⁴ *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").

of multijurisdictional uniformity whenever he might want it. *Id.*, 1.

Compared with the state of affairs before the compact, where unilateral enactments of UDITPA by various states lacked any binding obligation of fidelity to its terms, the viability of this new agreement, and its effectiveness in quelling the threat of federal intervention, depended upon availability of the standard apportionment formula for multistate taxpayers. As to the issue now before the Court, namely, whether states were bound to honor this compact, the Chairman of the then new Multistate Tax Commission wasted little time in proclaiming at its first meeting in 1967 that "the compact was a legally binding instrument without Congressional consent." The Willis recommendations thereafter faded into oblivion.

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Amici then discussed their old coalition's litigation against the MTC in the 1970s and the abusive MTC multistate audits that triggered that litigation. The coalition sued unsuccessfully to invalidate the compact due to its lack of congressional approval. The case made its way to the U.S. Supreme Court, which concluded that the compact was valid but immune from the requirement of Congressional approval.⁵

The decades following saw states tinkering with modifications to UDITPA's apportionment principles. This in turn made the uniform apportionment election 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 reduce tax liabilities. This put taxpayers and compact party states on a collision course that spawned the current litigation brought in California by a group led by Gillette, in Michigan by IBM and others, in Oregon by HealthNet, and in other compact party states by other concerned taxpayers.

Quoting a speech by President Kennedy contemporaneous with the Willis Commission's activities, the U.S. Steel coalition noted that the voluntary nature of our self-assessment tax system depends upon the confidence taxpayers have in its fairness. The Willis Report itself also expressed the same concern as a foundation for its recommendation of uniform apportionment rules for multistate taxpayers. Amici then reasoned that the compact's uniform apportionment election provision provided adequate assurance so that Congress did not have to act. They then appropriately characterized the recent spate of repudiations by compact party states as breaching the central element of the bargain they made with the public when they entered into the compact and called upon the U.S. Supreme Court to take the *Gillette* case in order to remind California and other party

⁵ *U.S. Steel*, 434 U.S. at 471.

states that they are legally bound by the Constitution and their own compact not to do this. Failure to do so, the coalition concluded, would result in an erosion of public confidence that is likely to be significant.

2. California's 'Gillette' Decision Conflicts with 'Northeast Bancorp'

Amici also expressed concern that the California decision conflicts with the U.S. Supreme Court's decision in *Northeast Bancorp v. Board of Governors*, 472 U.S. 159 (1985). In that case, the Supreme Court found that state banking legislation authorized by federal statute did not amount to an implied contract. The Court did not, however, establish its analytical criteria there as a general test for evaluating the existence of a binding contract outside the context of that case. Amici criticized the litmus test that California courts created based on an incorrect reading of *Northeast Bancorp* and the application of that novel test to find that the compact was non-binding, arguing that the case was limited to its facts and never purported to establish an exhaustive list of factors to determine whether a compact was advisory or binding. In this way, the taxpayers argued that California overstated the importance of this case by relying upon it to disallow the election.

The MTC is singing a different tune today in its role as an enabler of California's breach of the compact.

The coalition then provided historical perspective demonstrating that while recommendations of the Multistate Tax Commission (MTC) were advisory, the Multistate Tax Compact itself has always had force and effect. They cited the MTC's multistate audit function, the

binding results of those audits, and the California Franchise Tax Board's (FTB) own failed attempt in 1999 to withdraw from the compact under its repeal provisions. They also cited a 1999 California Attorney General opinion that formal repeal of the compact would be the only way to avoid its future obligations—a view diametrically opposed to the FTB's current litigating position that California's adoption of the double-weighted sales factor repealed its compact obligations by implication. Amici also noted that the MTC's litigating position in *Gillette* is at odds with the statements of its inaugural chairman and questioned whether *U.S. Steel* would have even needed to be litigated in the 1970s, were the compact—and its authority to empower the MTC to conduct multistate audits—merely advisory.

Conclusion

Whether the U.S. Supreme Court grants review in the *Gillette* case remains to be seen.⁶ If it considers the background and history of the compact—which all interested parties contemporaneously considered valid and binding—it ought to review the case. If the Court wishes to quash a novel and improper reading of one of its own opinions, it ought to review the case. Perhaps most importantly, if the Court takes seriously President Kennedy's admonition to preserve "confidence in the fairness of the tax laws" and also in the "uniform and vigorous enforcement of these laws," it ought to review the case. If the Court declines to review this case, the taxpayer community must press on with the effort, and ultimately bring more cert. petitions, for justice is on our side.

⁶ On August 1, 2016, Respondent California Franchise Tax Board filed its brief in opposition to *Gillette's* certiorari petition. The Supreme Court is likely to consider the certiorari petition in one of the early conferences of the new term, which begins in late September.