No. 15-1442

IN THE
Supreme Court of the United States

THE GILLETTE COMPANY, *et al.*,
Petitioners,
v.

CALIFORNIA FRANCHISE TAX BOARD, *et al.*,
Respondents.

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

BRIEF FOR THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* SUPPORTING PETITIONERS

LINDA E. KELLY
QUENTIN RIEGEL
LELAND P. FROST
MANUFACTURERS' CENTER FOR LEGAL ACTION
733 Tenth Street, NW
Suite 700
Washington, DC 20001

Counsel for the National Association of Manufacturers

FREDERICK LIU
Counsel of Record
HOGAN LOVELLS US LLP
555 Thirteenth Street, NW
Washington, DC 20004
(202) 637-5600
frederick.liu@hoganlovells.com

Counsel for Amici Curiae

[additional counsel listed on inside cover]

Additional counsel:

KATE COMERFORD TODD
WARREN POSTMAN
U.S. CHAMBER LITIGATION
CENTER, INC.
1615 H Street, NW
Washington, DC 20062

Counsel for the Chamber of Commerce for the United States America

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

BRIEF FOR THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* SUPPORTING PETITIONERS

INTEREST OF *AMICI CURIAE*

The National Association of Manufacturers (NAM) is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all 50 states. Manufacturing employs over 12 million men and women, contributes roughly $2.17 trillion to the U.S. economy annually, has the largest economic impact of any major sector, and accounts for three-quarters of private-sector research and development. The NAM is the powerful voice of the manufacturing community and the leading advocate for a policy agenda that helps manufacturers compete in the global economy and create jobs across the United States.[1]

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every

[1]No party or counsel for a party authored this brief in whole or in part. No party, counsel for a party, or person other than *amici curiae*, their members, and their counsel made any monetary contribution intended to fund the preparation or submission of this brief. All parties were notified of *amici*'s intent to file this brief at least 10 days before it was due, and have consented to its filing in letters that have been lodged with the Clerk.

size, in every economic sector, and from every region of the country. One important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the Judiciary. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community.

Thousands of the NAM's and the Chamber's members engage in interstate commerce, and do business in states that are party to the Multistate Tax Compact. Accordingly, the question whether the Compact is binding is of significant importance to *amici* in this case.

SUMMARY OF ARGUMENT

The question presented by the petition in this case is whether the Multistate Tax Compact has the status of a contract that binds its signatory states. Among other things, the Compact requires its member states to provide taxpayers the option of apportioning their income according to a three-factor, equal-weighted formula. For over fifty years, businesses across the nation have relied on that formula in making key decisions, like where to expand their sales or open a manufacturing plant. They have also long relied on that formula in making sure that their income is apportioned in the same, consistent way among multiple states.

Despite that reliance, the California Supreme Court in this case held that the Compact is not binding at all. Because that erroneous decision has immense practical consequences for American businesses, this Court should grant the petition for a writ of *certiorari* and reverse. If allowed to stand, the decision below would seriously undermine the pre-

dictability and uniformity of state taxation—the very things the Compact was supposed to promote.

None of this is to say that a state can never withdraw from the Compact. But under Article X, a state may withdraw only by repealing the Compact *in its entirety*. California did not do that here, and that makes all the difference. After all, the requirement of complete withdrawal serves a number of important purposes. It assures Congress that joining the Compact is a true commitment, making federal legislation in the area unnecessary. It avoids the unfairness of a state enjoying all of the benefits of membership without enduring all of the obligations. And it ensures that a state's decision to break from the Compact gets the close scrutiny from affected businesses that it deserves.

ARGUMENT

I. THE COMPACT'S STATUS AS A BINDING CONTRACT IS OF IMMENSE PRACTICAL IMPORTANCE TO BUSINESSES ACROSS THE NATION

The Multistate Tax Compact sets forth a number of rules governing the "proper determination of State and local tax liability of multistate taxpayers." Pet. App. 65a (Compact art. I(1)). Among them is the provision at issue here: the requirement that member states give businesses the option of apportioning their income according to a so-called "equal-weighted apportionment formula." *Id.* at 6a; *see also id.* at 67a (Compact art. III(1)). That formula determines how much of a business's nationwide income should be attributed to a particular state—and thus how much in income taxes the business must pay there—by giving equal weight to three factors: (1) the amount

of property the business holds in the state (the property factor); (2) the amount of compensation the business pays employees in the state (the payroll factor); and (3) the amount of sales the business makes in the state (the sales factor). *See id.* at 72a-74a (Compact art. IV(9)-(15)).

The petition asks this Court to decide whether the provisions of the Compact are binding on the many states that have joined it. This Court should grant the petition and hold that the answer is yes. Businesses across the nation have long relied on the Compact as a source of predictable and uniform rules governing the amount of income taxes they owe not just in California but in other member states. The petition thus presents an issue of far-reaching importance, warranting this Court's review.

A. Businesses Have Long Relied On The Compact As A Source of Predictable Taxation Rules

To appreciate the significance of the question presented, consider the following example. A company manufactures and sells widgets in State A, which is a member of the Compact. The company is growing and wants to expand its sales into a neighboring state—but which one? After reviewing the tax regimes of the surrounding states, it decides to expand into State B. The rationale for that decision is simple: State B is also a member of the Compact, and so is obligated to let the company allocate its income according to the equal-weighted apportionment formula. Unless State B withdraws from the Compact, the amount of income taxes the company owes in State B will never exceed what that formula yields. And that sort of certainty is important to the

company, which is deciding where to sell for the long term.

After it has already expanded into State B, however, the company is told that the Compact was never binding. Without going through the process of "withdraw[ing] from th[e] compact," Pet. App. 87a (Compact art. X(2)), State B amends its tax code to eliminate the equal-weighted formula as an option. Under a different formula imposed by the state, the company owes State B more in income taxes than it had ever anticipated. If the company had known that State B could simply disregard the Compact as non-binding, it would have never expanded there in the first place; it decided to grow its business in State B only because it thought State B was committed to following the Compact.

The decision below makes this hypothetical a reality. Thousands of American businesses engage in commerce across state lines. Indeed, "[m]ost companies engaged in interstate commerce make sales into many more States than the number in which they have places of business, and probably into many more States than the number in which they have payroll." H.R. Rep. No. 88-1480, vol. 1, at 528-529 (1964). American companies thus make decisions all the time about where they should do business.

Those decisions are often affected by the potential tax consequences of expanding into one state versus another. State and local taxes, after all, represent a "significant" part of a business's overall costs. Tax Found. & KPMG, *Location Matters: The State Tax Costs of Doing Business* 1 (2015).[2] In fiscal year 2012

[2] *Available at* http://goo.gl/rq45QZ.

alone, manufacturers paid nearly $90 billion in taxes to state and local governments. Mfg. Inst., *State & Local Taxes by Funding Source*.[3] It should come as no surprise, then, that "business location decisions for new manufacturing facilities, corporate headquarter relocations, and the like are often influenced by assessments of relative tax burdens across multiple states." Tax Found. & KPMG, *supra*, at 1.

The Compact was supposed to make those assessments more predictable by "requir[ing]" member states to "make the [equal-weighted apportionment formula] available to any taxpayer wishing to use it." Council of State Gov'ts, *The Multistate Tax Compact: Summary and Analysis* 1 (1967); *see also id.* at 6 ("The Multistate Tax Compact provides that the [equal-weighted apportionment formula] will be available in all party States to any multistate taxpayer wishing to use it."). The availability of that formula was supposed to help businesses make sound, long-term decisions—like where to build a new factory, or where to hire more salespeople. A business could expand its sales in a member state, confident that those sales would be given equal weight, and not double counted, in determining how much in taxes it would have to pay.

The decision below, however, threatens to disrupt the settled expectations of countless businesses that have relied on the availability of the equal-weighted formula. Like the hypothetical company above, many businesses now find themselves potentially owing much more in taxes than they had originally anticipated, if (as the decision below holds) a member

[3] *Available at* http://goo.gl/JMAI9M.

state is not required to offer the formula. The amounts at stake are large. In California alone, businesses would owe an additional $750 million in taxes. Pet. 29. But this case does not affect just California: Eight other states have similarly repudiated parts of the Compact without formally withdrawing. *Id.* at 28. When those states are taken into account as well, the question presented could affect a total tax liability of $3 billion nationwide. *Id.* at 29.

B. Businesses Have Long Relied On The Compact As A Source Of Uniform Taxation Rules

The consequences of the decision below do not end there. The Compact was intended to make income taxes not only more predictable, but also more uniform. *See* Pet. App. 65a (Compact art. I(2)) ("The purposes of this compact are to * * * [p]romote uniformity or compatibility in significant components of tax systems."); *id.* at 25a (explaining that a "central purpose" of the Compact was to "secure a baseline level of uniformity"). By opting for the equal-weighted apportionment formula in each member state, a business could ensure that each of those states apportioned its income in the same way. *See* Council of State Gov'ts, *supra*, at 6.

Such uniformity, in turn, would serve another key purpose: "[a]void[ing] duplicative taxation." Pet. App. 65a (Compact art. I(4)). "[S]ome risk of duplicative taxation exists whenever the States in which a corporation does business do *not* follow identical rules for the division of income." *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 278 (1978) (emphasis added). When states *do* follow identical rules, by contrast,

the "possibility of double taxation" goes away. Council of State Gov'ts, *supra*, at 1.

Consider a company that does business across state lines. The company holds all of its property and pays all of its employees in State A, while also making $10 million in sales there. In State B, the company holds no property and pays no employees, but makes $15 million in sales. If both states applied the same equal-weighted formula, 80% of the company's income would be taxable in State A, while 20% of its income would be taxable in State B.[4] By contrast, if State A applies an equal-weighted formula and State B applies a formula that gives double weight to the sales factor, 30% of its income would be taxable in State B—resulting in 10% of its income being taxed twice.[5] Uniformity avoids double taxation—and by avoiding double taxation, promotes fairness. *See* Pet. App. 65a (Compact art. I(1)) (identifying "the equitable apportionment of tax bases" as one of the purposes of the Compact).

If allowed to stand, the decision below would undermine these goals. Companies that engage in interstate commerce would no longer be able to

---

[4]Because the company has 100% of its property, 100% of its payroll, and 40% of its sales in State A, the equal-weighted formula apportions 80% of the company's income (240% ÷ 3) to State A. Because the company has 0% of its property, 0% of its payroll, and 60% of its sales in State B, the equal-weighted formula apportions 20% of the company's income (60% ÷ 3) to State B.

[5]Because the company has 0% of its property, 0% of its payroll, and 60% of its sales in State B, the double-weighted-sales formula apportions 30% of the company's income (120% ÷ 4) to State B.

guarantee that each member state applied the same formula in apportioning their income. Absent that guarantee, companies would face a serious risk of duplicative taxation as they do business across state lines.

In short, whether the Compact is a binding contract is of immense practical importance to businesses nationwide. The petition should be granted to resolve, once and for all, the status of the Compact.

II. A STATE SHOULD NOT BE PERMITTED TO EVADE THE COMPACT'S WITHDRAWAL PROVISION

Because the Compact is a binding contract, California was obligated to give petitioners the option of having their incomes apportioned according to the equal-weighted formula. If California no longer wished to be bound by that obligation, it could have withdrawn from the Compact. Article X of the Compact sets forth the means for doing so: "Any party State may withdraw from this compact by enacting a statute repealing the same." Pet. App. 87a.

At the time of this litigation, "California had *not* withdrawn from the Compact." *Id.* at 46a. To be sure, California enacted a statute in 1993 purporting to repudiate *one* of the Compact's provisions—the requirement that taxpayers be given the option of electing the equal-weighted formula. *See* Cal. Rev. & Tax Code § 25128(a). But as the California Court of Appeal explained, Article X "allows only for *complete* withdrawal from the Compact." Pet. App. 46a (emphasis added). It does not allow for "piecemeal amendment or elimination of compact provisions." *Id.* The statute that California enacted in 1993 thus

did not effect a withdrawal from the Compact. *Id.* at 7a.

That Article X requires a complete withdrawal is not just a formalism. There are important reasons why withdrawing from the Compact requires repealing the Compact *as a whole*.

First, requiring a complete withdrawal is key to one of the principal purposes of the Compact: staving off federal legislation regulating state taxation of interstate businesses. Fifty years ago, a report commissioned by Congress decried the "diversity and multiplicity" of state tax regimes. H.R. Rep. No. 89-952, vol. 4, at 1133 (1965). In light of that report, members of Congress proposed legislation to "mandate uniformity in state taxation." Pet. 4; *see also* Council of State Gov'ts, *supra*, at 4-5 (summarizing proposed legislation). This movement toward federal legislation prompted concerns among states that Congress would "curtail[] State and local taxing authority." Council of State Gov'ts, *supra*, at 2. California, in particular, feared losing up to $100 million in state tax revenue. A.B. 1304 (Russell) (Cal. 1974), The Multistate Tax Compact: Summary Argument for the Bill 1.

The Compact was developed as an alternative to federal legislation. *See* Council of State Gov'ts, *supra*, at 1 ("The threat of federal action imparts a high degree of urgency to the undertaking."). The idea was that if enough states joined the Compact, a baseline level of uniformity would be achieved without the need for federal intervention. But the idea would work only if, by joining the Compact, states committed to following *all* of its provisions. If states could simply pick and choose which provisions of the

Compact to follow, the Compact would be considered a poor substitute for binding federal legislation. *See id.* at 5 (explaining that the Compact had "to assure taxpayers and public officials that multistate machinery exists to cope with any multistate aspects of the State and local tax problem").

There are good reasons to believe that Article X of the Compact played a crucial role in forestalling congressional intervention. Because Article X permitted only complete withdrawal, member states had to abide by *all* of the Compact's provisions, even ones they did not like. Joining the Compact was thus a true commitment, and Congress ultimately saw no need for federal legislation. Instead, "[f]ollowing the Compact's adoption, none of the proposed federal bills became law." Pet. 5. The decision below would nevertheless allow member states to repudiate the Compact one provision at a time, as California did here. By depriving Article X of any real meaning, the decision below allow states to back out on the very commitment that helped stave off federal intervention.

Second, making withdrawal an all-or-nothing proposition ensures that a state cannot reap the benefits of the Compact without bearing the obligations. Contrary to the decision below, the Compact is more than just "a model law." Pet. App. 13a. By joining the Compact, a state receives various benefits beyond incorporating "model" provisions into its tax code. For example, every state that joins the Compact becomes a voting member of the Multistate Tax Commission. *Id.* at 76a (Compact art. VI(1)). As voting members, states may exercise influence over the development of tax laws, *id.* at 79a (Compact art. VI(3)), as well as the adoption of regulations for

administering such laws. *Id.* at 81a (Compact art. VII(1)). In addition, member states may ask the Commission to conduct audits of multistate taxpayers. *Id.* at 82a (Compact art. VIII); *see also id.* at 17a, 31a. A single audit, performed by the Commission, could thus "suffice to verify [the taxpayer's] returns to all jurisdictions," saving member states time and expense. Council of State Gov'ts, *supra*, at 7.

These are no small benefits. When California joined the Compact over forty years ago, the sponsor of the legislation specifically touted the fact that membership in the Compact would "permit California to participate in all proceedings" in front of the Commission and "authorize[] California to participate in the Commission's joint audit program." A.B. 1304 (Russell) (Cal. 1974), The Multistate Tax Compact: Author's Explanation 2. Indeed, the sponsor urged, "by becoming a regular member California could have an effective voice in assisting and guiding" the Commission as it tackles "state tax problems having a national impact." A.B. 1304 (Russell) (Cal. 1974), The Multistate Tax Compact, Detailed Explanation 2.

And yet, when California purported to eliminate the equal-weighted formula as an option in 1993, it did not relinquish any of these benefits. In fact, California served on the Executive Committee of the Commission for at least eight more years.[6] If Cali-

[6]*See* Multistate Tax Comm'n, *Report of Activities for the Year Ending June 30, 1994* (1994); Multistate Tax Comm'n, *Annual Report FY2005-06*, at 4 (2006); Multistate Tax Comm'n, *Annual Report FY2006-07*, at 5 (2007); Multistate Tax Comm'n, *Annual Report FY2007-08*, at 5 (2008); Multistate Tax Comm'n, *Annual*

fornia was to continue reaping all of the benefits of the Compact, it should have been required to continue bearing all of its obligations—including the requirement that it make the equal-weighted formula available to taxpayers. Article X thus prohibits the sort of piecemeal withdrawal that California sought to accomplish. Pet. App. 46a.

Third, requiring a complete withdrawal ensures that a state's decision to break from the Compact gets the close scrutiny it deserves. In each member state, the Compact's provisions affect countless businesses. If a state is to consider eliminating those provisions, it should give those businesses adequate notice. Requiring the state to repeal the entire Compact does just that, guaranteeing that those affected will be aware of what is happening. Those businesses can then make their voices heard, either for or against that wholesale change. The process required by Article X thus fosters "a measured, deliberative decision prior to withdrawal." *Id.* at 41a. California's own experience demonstrates the importance of that process: California considered but *rejected* a proposal to withdraw from the Compact in 1999, despite having purported to repudiate the Compact's apportionment formula six years earlier. *See* A.B. 753 (Cal. 1999).

In short, the California Supreme Court should have required California to go through the Article X process to break from the Compact. Instead, the

---

Report FY2008-09, at 5 (2009); Multistate Tax Comm'n, *Annual Report FY09-10*, at 3 (2010); Multistate Tax Comm'n, *Annual Report FY10-11*, at 3 (2011); Multistate Tax Comm'n, *Annual Report FY11-12*, at 3 (2012). All of these reports are available at http://goo.gl/iUqt3v.

court allowed the state to selectively repudiate one of the Compact's many provisions. Because the Compact's status as a binding contract is vitally important to American businesses, this Court should grant the petition and reverse the judgment below.

CONCLUSION

For the foregoing reasons and those in the petition, the petition should be granted.

Respectfully submitted,

FREDERICK LIU
Counsel of Record
HOGAN LOVELLS US LLP
555 Thirteenth Street, NW
Washington, DC 20004
(202) 637-5600
frederick.liu@hoganlovells.com

Counsel for Amici Curiae

LINDA E. KELLY
QUENTIN RIEGEL
LELAND P. FROST
MANUFACTURERS' CENTER FOR LEGAL ACTION
733 Tenth Street, NW
Suite 700
Washington, DC 20001

Counsel for the National Association of Manufacturers

KATE COMERFORD TODD
WARREN POSTMAN
U.S. CHAMBER LITIGATION CENTER, INC.
1615 H Street, NW
Washington, DC 20062

Counsel for the Chamber of Commerce for the United States America

JUNE 30, 2016