Texas: Supreme Court to decide if businesses can choose income apportionment formula

David M. Kall | Monday, June 6, 2016

The California Supreme Court decided the case ***Gillette Co. v. Franchise Tax Bd.*** on Dec. 31, 2015. The court concluded that the California Franchise Tax Board was not bound by the multistate tax compact's income apportionment formula when assessing tax liability. Instead, as we described in our **discussion** of the case, the board was within its rights to utilize the state's statutory formula for income apportionment, which precludes use of the compact's formula, and which left the plaintiffs unable to collect the $34 million refund they sought.

Subsequent to the decision, the board released **guidance** in response to taxpayer inquiries on what action to take thereafter. Presumably anticipating that the plaintiffs would seek review in the U.S. Supreme Court, the guidance noted that the board would defer certain decisions until all litigation is complete. On May 27, 2016, the high court did indeed receive a petition for a writ of certiorari, **case number 15-1442**.

Texas

The Lone Star State is one jurisdiction with an interest in *Gillette*. There, Graphic Packaging Corporation would like to see *Gillette* overturned. It is fighting its own apportionment **battle**, and has recently filed its final **reply brief** on its **petition for review** in the Texas Supreme Court.

The question in Graphic Packaging's case is whether, with respect to the state's franchise tax, the company may elect the three-factor apportionment formula set forth in the compact, which Texas adapted in its tax code, or whether it must apply the state's statutory single-factor formula. The plaintiffs in *Gillette* posed a similar question, but in Texas, the answer turns to whether the Texas franchise tax is one on income. The court below, agreeing with the trial court, decided that the Texas franchise tax is not an income tax, and that the three-factor formula is not available as an alternative apportionment formula. Rather, the result requires Graphic Packaging to use the statutory single-factor formula.

In its petition for review, Graphic Packaging explained that the underlying purpose of the compact, which Texas, Illinois, Missouri, and other states formed in 1967, was to stave off federal interference and reduce administrative burdens and multiple taxation. It gave multistate taxpayers the right to choose to apportion their income using either the three-factor formula set forth in the compact, or a state formula. The compact defines "income taxes" broadly to achieve its goals.

Like California, Texas argues that multistate taxpayers may not choose which formula to apply and are bound by the revenue-maximizing statutory formula. Here, because the state does not include the franchise tax in its definition of income tax, the appellate court's conclusion means that Graphic Packaging may not choose which formula to apply to its franchise tax obligation.

Graphic Packaging justifies its position on the grounds that:

1. The franchise tax authorizes deductions unrelated to particular transactions, which makes it an income tax.
2. The compact requires broad, liberal interpretation of the term “income tax.”
3. The legislature’s own definitions have no bearing on the compact’s definition. It argues that to let the appellate court’s decision stand threatens the pact’s underlying promise to reduce taxpayer burdens.

Implications

Several other states will feel the effects of the board’s conclusion in *Gillette*, like Michigan, with the case *Gillette v. Dep’t of Treasury*; Minnesota’s *Kimberly-Clark Corp. v. Commn’r of Revenue*; and Oregon’s *Health Net, Inc. v. Dep’t of Revenue*.

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