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December 11, 2018

The Honorable Tani Cantil-Sakauye, Chief
Justice, and Honorable Associate Justices
California Supreme Court
350 McAllister Street
San Francisco, CA 94102-4797

RE: Letter of Amicus Curiae Council On State Taxation (COST) in Support of
Appellant's Petition for Review

To the Honorable Chief Justice and Associate Justices of the California
Supreme Court:

The Council On State Taxation (COST) respectfully requests this Court grant the Appellant's Petition for Review in *Harley-Davidson Inc. & Subs. v. California Franchise Tax Board* ("Harley-Davidson"). The *Harley-Davidson* case involves a facially discriminatory tax scheme the Court of Appeal upheld as valid by turning the constitutional test on its head. This Court should grant Appellant's Petition for Review to correct the Court of Appeal's misapplication of the strict scrutiny test to a facially discriminatory provision, and to ensure the Court of Appeal's approach does not erode the protections of the U.S. Commerce Clause and deter voluntary compliance.

COST is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today, COST has grown to an independent membership of approximately 550 major corporations engaged in interstate and international business representing every industry doing business in every state. COST members employ a substantial number of California citizens, own extensive property in California, and conduct substantial business in California. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities—a mission it has steadfastly maintained since its creation.

Sound tax policy demands clear rules to provide multijurisdictional taxpayers predictability. And, although there are many areas of state and local tax that are currently in flux (*i.e.*, state tax application of newly adopted Internal Revenue Code provisions, and nexus standards after *Wayfair*), the standard of review for a facially discriminatory tax scheme has been well established and stable for the last several decades. The Court of Appeal's misapplication of that standard will have implications beyond this case and will, at a minimum, erode confidence in tax administration and deter taxpayer compliance.

As laid out by the Appellant in its Petition for Review as well as its prior briefing in this case, intrastate and interstate taxpayers are treated differently under California corporate income tax laws. While intrastate taxpayers are given the choice between separate and combined reporting, interstate taxpayers are required to report their income on a combined basis. *See* Cal. Rev. & Tax Code §§ 25101.15 and 25101, respectively. And this differential treatment provides real tax benefits, amongst others, solely to intrastate businesses. Moreover, the mere fact that intrastate taxpayers are given a choice between these filing methods and interstate taxpayers are not (*i.e.* intrastate and interstate taxpayers are treated differently) was sufficient for the Court of Appeal in its first decision (*Harley-Davidson Inc. v. Franchise Tax Bd.*, 237 Cal. App. 4th 193 (2015)) to deny the Franchise Tax Board's demurrer, and it should have been sufficient for the Court of Appeal to determine that California's statutory scheme is facially discriminatory.

The Court of Appeal in its most recent decision, however, sidestepped the issue of actually ruling on discrimination even though its prior decision found facial discrimination to be an "unavoidable conclusion." (237 Cal. App. 4th at 205.) The Court of Appeal found that even if the tax scheme discriminated against interstate commerce, it was constitutionally sound because the tax scheme was justified under strict scrutiny. But to reach this result and overcome strict scrutiny, it shifted the burden of proof to the taxpayer to show that the discriminatory provision was not justified. With this decision, the Court of Appeal has subverted the strict scrutiny test. Instead of applying the strict scrutiny standard as it has been interpreted for decades, which would have imposed a "heavy" burden on the state to justify the discrimination, the Court of Appeal required the taxpayer to prove there was a reasonable nondiscriminatory alternative. The shifting of the burden to the taxpayer in this case is plainly out of step with prior U.S. and California Supreme Court precedent, and this Court should grant review of Appellant's Petition for Review to correct the Court of Appeal's misapplication of the test.

If not reversed, the Court of Appeal's misapplication of the strict scrutiny test is likely to have consequences beyond this case. This approach would inevitably erode Constitutional protections granted to all taxpayers as it places the burden on taxpayers, not the state, to prove the state's case (*i.e.*, that there was no reasonable nondiscriminatory alternative). It is not the responsibility of taxpayers to show that the state has no other reasonable nondiscriminatory alternatives. Rather, it is the responsibility of the state to not enact laws that discriminate against out-of-state taxpayers by treating them differently than in-state taxpayers. And, if this becomes the new test, the state will likely be emboldened to pass facially discriminatory laws, particularly when doing so favors in-state constituents and penalizes out-of-state taxpayers who would now have to carry the burden formerly imposed on the state. Permitting this uneven and unfair application of state corporate income tax laws to out-of-state taxpayers to persist would clearly erode confidence in the state tax system and ultimately deter voluntary compliance.

For these reasons, COST respectfully urges this Court to grant Appellant's Petition for Review of *Harley-Davidson*.

Sincerely,

A handwritten signature in black ink, appearing to read "Nikki Dobay". The signature is fluid and cursive, with a long horizontal stroke at the end.

Nikki Dobay

CC: COST BOARD OF DIRECTORS
DOUGLAS L. LINDHOLM, COST EXECUTIVE DIRECTOR