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Gillette wins California Multistate Compact Case in Court of Appeal

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In 1966, the California Legislature adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA"),[1] a model law which had been promulgated in 1957 by the National Conference of Commissioners on Uniform State Law. UDITPA contained a corporate apportionment formula consisting of equally weighted payroll, property and sales factors. In 1974, the California Legislature adopted the Multistate Tax Compact ("Compact"), which incorporates UDITPA nearly word for word.[2] However, in 1993, the California Legislature enacted a statute which moved away from an equal weighting of the payroll, property and sales factors to require corporate taxpayers, with certain exceptions, to apportion income using a double-weighted sales factor.[3] The Gillette Company filed suit in California against the California Franchise Tax Board ("FTB"), arguing it was entitled to elect to use an equally weighted apportionment formula, notwithstanding the California Legislature's attempt to require use of a double-weighted sales factor, because the Legislature had not and could not amend the Compact and had not repealed the Compact. Gillette lost in the California trial court, and then appealed to the Court of Appeal, First District. Along the way, a number of other cases presenting the same issue were procedurally consolidated with *Gillette*.

On July 24, 2012, the Court of Appeal ("Court") issued its published and precedential decision in *Gillette*. The Court held the Compact is a valid multistate compact and that California is bound by it and its apportionment election provision unless and until California withdraws from the Compact by repealing its enactment in California. Further, the Court held that California cannot vary the terms of the Compact, so long as it is a part of California law. Accordingly, Gillette was entitled to elect to use the equally weighted formula provided in the Compact.

There are two very large "unknowns" at the moment regarding the election issue presented in the *Gillette* Court of Appeal decision. First, the FTB may ask the California Supreme Court to accept the *Gillette* case for review. While the California Supreme Court is not required to accept the case for hearing, the odds would seem in favor of the Court accepting the case. This means the ultimate decision in *Gillette* would not be known for perhaps 18-24 months, i.e., after the case is briefed and argued, a decision would be issued by the California Supreme Court. Second, On June 27, 2012, and while *Gillette* was pending at the Court, Governor Brown signed S.B. 1015, which repealed the Compact. Having the possibility in mind of other taxpayers' claims for refund generated by a decision in *Gillette* adverse to California, S.B. 1015 also states that under the Compact a California election to use the equally weighted factor must be made on an *original* timely

[1] Cal. Rev. & Tax. Code secs. 25120-25139.

[2] Cal. Rev. & Tax. Code, sec. 38001 *et seq.*

[3] Cal. Rev. & Tax. Code sec. 25128.

filed return for the taxable period for which the election is to apply. Accordingly, S.B. 1015 essentially guarantees that even assuming Gillette ultimately prevails on the merits, there will be further litigation on whether an election under the Compact can be made on an amended return, with FTB arguing the answer is "no" based on S.B. 1015, and taxpayers arguing "yes" because S.B. 1015 cannot retroactively change the law on that issue.

If you have any questions or would like further information on these developments, please contact Morrison & Foerster's California State + Local Tax Group:

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