In the Supreme Court of the State of California

THE GILLETTE COMPANY & SUBSIDIARIES, **Plaintiffs and Appellants,** v. CALIFORNIA FRANCHISE TAX BOARD, AN AGENCY OF THE STATE OF CALIFORNIA, **Defendant and Respondent.**

Case No. S206587

First Appellate District Division Four, Case No. A130803
San Francisco County Superior Court, Case No. CGC-10-495911
The Honorable Richard A. Kramer, Judge

RESPONDENT'S SUPPLEMENTAL REQUEST FOR JUDICIAL NOTICE MOTION, MEMORANDUM AND SUPPORTING PAPERS

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MOTION

Pursuant to Evidence Code sections 452 and 459, and California Rules of Court, rule 8.252, Respondent Franchise Tax Board (the "Board") moves this court to take judicial notice of the below-listed document in support of its Reply Brief on Merits:

E. A. England, Florida Corporate Income Taxation: Background, Scope and Analysis, An Introduction to Florida Corporate Income Taxation 4, 14 (1972), a true and correct copy of the relevant pages are attached hereto as Exhibit E.

This document is attached to this motion as required by California Rules of Court, rule 8.252(a)(3). The motion is based on the attached memorandum of points and authorities, and supporting declaration, filed herewith.

Dated: September 20, 2013 Respectfully submitted,

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MEMORANDUM

Pursuant to Evidence Code section 459, "[a] reviewing court may take judicial notice of any matter specified in Section 452." The attached article regarding corporate income taxation in Florida consist of "[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy" under Evidence Code section 452, subdivision (h).

The document described above and attached hereto falls into these categories and judicial notice is proper as to this document.

A. Why the Matter to be Noticed Is Relevant to the Appeal

The history of the Multistate Tax Compact supports the Compact member states' longstanding and consistent construction of the Compact that permits member states to eliminate or modify the election and income apportionment provisions contained in Articles III and IV of the Compact. Florida's legislative action in repealing the election and apportionment provisions contained in Articles III and IV of the Compact supports the member states' construction because the legislation did not affect Florida's continued good standing as a Compact member state.

In addition, Gillette contends Florida actually "maintained the three-factor, equal-weighted Compact formula," therefore Compact member states knew they could not eliminate the election provision. (Answer Brief at p. 37.) This representation is wrong. While Florida did maintain a "three factor formula," it did not maintain the equal-weighted formula. Florida used a double-weighted sales factor formula, just as California did in Revenue and Taxation Code section 25128. The appended article discussing Florida's tax laws and statutes supports the fact that Florida adopted a "destination" test for determining the source of sales in 1971, which involved weighting the three-factor formula by assigning fifty percent of the apportionment formula to sales, and twenty-five percent each

to payroll and to property. Thus, Florida's "three factor" formula is not the equal-weighted Compact formula.

B. Whether the Matters to Be Noticed Were Presented to the Trial Court

This document was not presented to the trial court as the appeal in this matter was taken after the Board successfully demurred to plaintiffs' complaints in the trial court.

C. Whether the Matters to Be Noticed Relate to Proceedings Occurring After Judgment

This document is not related to any proceedings occurring after the order or judgment that is the subject of this action.

For each of the foregoing reasons, the Board respectfully requests that the Court take judicial notice of the article in Florida Corporate Income Taxation: Background, Scope and Analysis, An Introduction to Florida Corporate Income Taxation.

Dated: September 20, 2013

Respectfully submitted,

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AN INTRODUCTION TO

FLORIDA CORPORATE INCOME TAXATION

CORPORATE INCOME TAXATION IN FLORIDA: BACKGROUND, SCOPE, AND ANALYSIS†

*Arthur J. England, Jr.**

On November 2, 1971, the voters of Florida approved a constitutional amendment that authorized the imposition of an income tax on corporations and other artificial entities.[1] Shortly after this referendum, the Governor of Florida convened the Florida legislature to act on the authorization. On December 8, 1971, the legislature adopted the Florida Income Tax Code,[2] which became effective January 1, 1972. This article presents a brief summary of the legislative processes leading to the enactment of that statute, describes the scope of income taxability in Florida, and discusses the extent to which the Florida tax law is tied to federal corporate income taxation.

The Legislative Process

On the day after approval of the constitutional amendment, every legislator, and most corporate business and industry representatives in Florida, were sent a draft income tax statute

†This article will discuss chapter 220 of the Florida Statutes as the "corporate" income tax statute. In fact, however, that statute imposes a tax on many artificial entities which are not, strictly speaking, incorporated enterprises, implementing a constitutional authorization to tax "other than natural persons." A discussion of the scope of Florida's tax law appears on pages 7-10 *infra*.

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[1] H.J. Res. 7-B, Jan. Spec. Sess. (Fla. 1971), containing the proposed amendment to Fla. Const. art. VII, § 5 (1968). The text of this amendment appears on page 8 *infra*.

[2] Fla. Stat. ch. 220 (1971) [hereinafter referred to as the Florida Code].

and explanatory report[3] that had been prepared by the staff of the Florida House of Representatives. This draft statute and two earlier drafts had been distributed throughout the state for analysis and commentary during the eight-month period preceding the November referendum. The third staff draft had also been analyzed for technical accuracy by select tax committees of The Florida Bar and the Florida Institute of Certified Public Accountants. The report, and a supplemental report[4] issued on November 17, raised and analyzed many of the policy considerations involved in the adoption of a state corporate income tax. Together these reports served to identify the major issues to be considered in committee hearings and floor debates.

The formal legislative process began on November 17, when members of the Senate Ways and Means Committee and the House Finance and Taxation Committee convened in joint session to conduct public hearings on corporate income taxation. At this hearing, the Governor of Florida addressed the joint committees on major aspects of corporate income taxation, and staff and industry began presentations of technical materials. On November 18 and 19 the Senate and House committees met separately to hear additional testimony and to consider and vote on most of the issues to be embodied in the proposed legislation. Each committee adopted for working purposes the complete draft statute that had been included in the original report.

On November 22 each legislator was sent a third staff report[5] which compared the policy decisions made by the House and Senate committees on November 18 and 19. This report served to isolate for further deliberation several difficult policy questions which the committees had considered, including five areas on which the respective committees had disagreed: (1) the

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[3] A. England, Report to the House on Proposed Corporate Income Tax Legislation (Nov. 3, 1971). Copies of this report and its supplements are on file in the Florida State Library, the library of the Supreme Court of Florida, and the law libraries of Florida State University, Stetson University, the University of Florida, and the University of Miami.

[4] A. England, Supplemental Report to the House on Proposed Corporate Income Tax Legislation (Nov. 17, 1971).

[5] A. England, Report to the Legislature on committee action relative to Proposed Corporate Income Tax Legislation (Nov. 22, 1971).

allowance of a premiums tax credit for insurance companies;[6] (2) the allowance of a gross receipts tax credit for utilities;[7] (3) the scope of an optional apportionment formula for Florida manufacturers;[8] (4) the allowance of special treatment for capital asset transactions; and (5) the adoption of a pure destination test, rather than a combined destination and origin test, for the sales factor of the apportionment formula.

On November 29 the Florida legislature formally convened in special session in response to the Governor's call. By this time, the news media in Florida had focused public attention on a limited number of controversial issues. Because the third staff draft statute had already been adopted by both the House and Senate committees, however, many more significant but unexciting aspects of corporate income taxation, such as filing

[6]Under Fla. Stat. ch. 624, insurance companies are subject to tax on their gross premiums. Florida Laws 1971, ch. 71-984, § 3, enacted in conjunction with the income tax statute, now grants a credit against this premium tax liability for the income tax payments of an insurance company. When this tax credit was granted the legislature also modified the tax position of non-Florida companies having a Florida regional home office to increase the overall tax burden of these companies in Florida. Fla. Stat. § 624.514 (1971).

[7]Chapter 203 of the Florida Statutes imposes a gross receipts tax on the retail sales of electricity, gas, telephone, and telegraph services in Florida by public utilities. In debating whether to grant these utilities a credit against their corporate income tax for payment of these taxes, some legislators suggested that discrimination among Florida consumers would result from a failure to provide the credit because the privately owned electric utilities would pass the new tax burden on to their customers while the municipally owned electric companies, not subject to the income tax, would not. In both the House and the Senate attempts were made to eliminate this apparent discrimination by devising some way to tax municipalities which own public utilities. H.R. Jour., Nov. Spec. Sess. 13-15 (Fla. 1971); S. Jour., Nov. Spec. Sess. 21 (Fla. 1971). All efforts to tax municipalities were defeated by the Senate and the House, but the matter of discrimination became moot because the legislature ultimately declined to allow any form of credit against the corporate income tax.

[8]At a time when an equally weighted three-factor apportionment formula was being deliberated by the House committee, a proposal to allow Florida manufacturers an optional apportionment formula, based 70% on sales, 15% on property, and 15% on payroll, was also under consideration. The Senate committee voted to expand the availability of this optional formula to Florida processors of natural resources such as citrus products and phosphates. When the legislature finally adopted an apportionment formula for all taxpayers which was somewhat more beneficial to Florida manufacturers than to non-Florida manufacturers, all forms of the optional formula were abandoned.

dates, accounting periods, and accounting methods, had become uncontroversial.

The Florida legislature remained in special session from November 29 through December 9. On November 30 the House of Representatives took up, considered, and passed a Florida Income Tax Code.[9] The House bill – committee substitute for House Bill 16-D – was considered and amended by the Senate Ways and Means Committee on December 1[10] and by the full Senate on December 2 and 3.[11] The amended bill was taken up by the House on December 6, at which time all Senate amendments were rejected for the purpose of sending all matters of difference to conference.[12] Conferees were then appointed by both bodies, and a series of conference committee hearings began. On December 8 a conference committee report was prepared for, submitted to, and approved by both bodies of the legislature.[13]

Scope of Taxation

For forty-seven years prior to the November referendum, section 5 of article VII of the Florida constitution (1968), and predecessor provisions of the 1885 constitution, contained a general prohibition against taxing "the income of residents or citizens of the state" except to the extent of credits or deductions allowed by the federal government.[14] In his inaugural address on January 4, 1971, newly elected Governor Reubin Askew announced his intention to seek a court determination whether corporations were immune from income taxation under the constitutional ban.

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[9] H.R. Jour., Nov. Spec. Sess. 12-18 (Fla. 1971).

[10] The Senate committee chose to amend the House bill rather than to adopt a bill of their own, although one had been prepared, or to substitute the text of their bill for all provisions following the enacting clause of the House bill.

[11] S. Jour., Nov. Spec. Sess. 16-19, 21-23 (Fla. 1971).

[12] H.R. Jour., Nov. Spec. Sess. 50-52 (Fla. 1971).

[13] *Id.* at 95-99; S. Jour., Nov. Spec. Sess. 53-56 (Fla. 1971).

[14] Fla. Const. art. VII, § 5 (1968) provided:

> No tax upon estates or inheritances or upon the income of residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.

On January 21, 1971, the Justices of the Florida supreme court rendered an advisory opinion to the Governor in which they construed the term "residents or citizens" to include corporations and other artificial entities.[15] On January 27 the Governor convened a special session of the Florida legislature to amend the constitution to allow taxation of corporations and other artificial entities. On February 3 the legislature adopted a joint resolution amending article VII, section 5 of the Florida constitution and it was this resolution which the voters approved in the November referendum.[16] The constitution was amended to read:

> (a) Natural Persons. No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.
>
> (b) Others. No tax upon the income of residents and citizens other than natural persons shall be levied by the state, or under its authority, in excess of 5% of net income, as defined by law, or at such greater rate as is authorized by a three-fifths (3/5) vote of the membership of each house of the legislature or as will provide for the state the maximum amount which may be allowed to be credited against income taxes levied by the United States and other states. There shall be exempt from taxation not less than five thousand dollars ($5,000) of the excess of net income subject to tax over the maximum amount allowed to be credited against income taxes levied by the United States and other states.

The scope of intended taxation is a significant matter under the amended Florida constitution because income taxability is authorized only with respect to "other than natural persons," while total tax immunity is continued for "natural persons." The establishment of these two mutually exclusive categories of persons was the technical method of achieving the general objective of legislators and voters in Florida to allow corporate income taxation comparable to that imposed by the federal government, while continuing the constitutional ban against personal income taxation. Although the constitution makes no

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[15] *In re* Advisory Opinion to the Governor, 243 So. 2d 573 (Fla. 1971).
[16] II J. Res. 7-B, *supra* note 1.

attempt to define "natural persons," the delineation between taxable and non-taxable persons is achieved in at least three other ways.

First, a preamble to the joint resolution[17] states that the intent of the amendment was to limit

> income tax immunity to natural persons, as opposed to artificial persons or entities created by or pursuant to law such as business corporations, professional corporations, banking associations, savings and loan associations and other entities brought into being by compliance with state or federal statutes . . . .

This declaration is instructive to some degree as to the types of persons meant to be taxable. The income tax statute itself contains further refinements of this declared intent.[18]

Secondly, the legislature expressly excluded from the tax partnerships, estates, and trusts, which are the principal tax subjects at or near the legal borderline between "natural" and "artificial."[19] Early in 1971 Governor Askew had asked the Tax Section of The Florida Bar to appoint a select committee of tax experts to advise him whether the proposed constitutional amendment would authorize the legislature to impose a "personal" income tax in Florida. On June 7, 1971, that committee advised the Governor that such a tax would continue to be prohibited in Florida. In its written opinion the committee observed, without reaching any conclusion, that the federal income tax history of "natural person" taxation evidenced a "gray area wherein it is difficult to determine on which side of the line a particular entity, such as a statutorily authorized partnership or trust, should fall."[20] Thus by avoiding these "gray areas," the legislature reduced the possibility of future constitutional challenge. The specific exclusion of these classes of "persons" also serves to conform the law to the federal conduit treatment of these tax subjects.

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[17] *Id.*

[18] Fla. Stat. § 220.02(1) (1971).

[19] Fla. Stat. §§ 220.02(1), 220.03(1)(b) (1971). By expressly excluding all partnerships from the provisions of the Florida Code, questions are avoided as to the "entity" status of partnerships under Fla. Stat. §§ 620.01, 620.081(3), or 620.40 (1971).

[20] Letter from Alan Lindsay to Governor Reubin Askew, June 7, 1971.

Thirdly, the Florida Code enumerates a number of artificial entities that are declared to be subject to income taxation or that are required to file income tax returns,[21] thereby further illuminating the intended scope of taxation. The list of taxable entities excludes those that are not solely statutory and therefore not wholly artificial in nature.

Federal Tax Parallels

Early in their consideration of income tax legislation, the Senate and House committees both concluded that Florida should look to federal corporate taxable income or one of its numerous equivalents for special industries[22] as the basis for taxing net income in Florida. When the House and Senate committees of the legislature adopted the third staff draft statute as their working model, they thereby adopted for Florida the federal methods and periods of accounting, the federal concepts of realization and recognition, a set of procedures for returns and declarations comparable to and integrated with federal counterpart provisions, and an automatic tie to federal audit adjustments.[23] By far the most significant aspect of this federal "piggyback" for Florida was the adoption of the federal tax concept of "income."[24]

An example of the tie-in with federal procedures is found in the provisions for return filing dates. Florida returns are due each year fifteen days after federal returns are required,[25] and extensions of time which are granted for filing federal returns will, if filed with the Department of Revenue and accompanied by a tentative tax payment, automatically extend the Florida filing date for the period of the federal extension if the total time of all extensions is not in excess of six months.[26] Another federal procedural parallel is found in the treatment of

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[21] Fla. Stat. § 220.03(1)(b) (1971).

[22] *See* Fla. Stat. § 220.13(2) (1971).

[23] A complete discussion of the federal tax parallels appears on pages 25-37 *infra*.

[24] One important effect of defining "income" in terms of federal realization concepts is the avoidance of problems relative to accrued property rights such as Illinois encountered when it commenced the taxation of income after a period of constitutional prohibition. *See* Thorpe v. Mahin, 43 Ill. 2d 36, 250 N.E.2d 633 (1969).

[25] Fla. Stat. § 220.222(1) (1971).

[26] *Id.* § 220.222(2)(a).

estimated tax returns and payments, which are required whenever the taxpayer expects a tax liability of $2,500 or more (equivalent to a net income of $50,000 or more subject to Florida tax).[27] These returns and payments, which encompass the same monthly periods as federal declarations,[28] are also due fifteen days after the federal due dates.

Deviations from Federal Tax

Neither the adoption of federal tax concepts for Florida nor the statutory effort to parallel federal tax procedures was able to avoid all deviation from federal corporate income taxation. The Florida legislature, new to the business of taxing income, soon discovered that states lack the ability to tax income on exactly the same basis as the federal government. Principal among the considerations that preclude wholesale adoption of federal taxable income are questions of jurisdiction, limitations on taxation under the federal public debt statute, constitutional limitations on the delegation of state legislative functions, and federal constitutional dictates of the commerce clause. These considerations prompted the Florida legislature to adopt four deviations from the federal tax scheme.

Mandatory Deviations

1. Future Federal Amendments.—In one of their little-noted determinations, the Senate and House Committees defeated a bill[29] designed to effect automatic adoption for Florida of all future federal amendments to the Internal Revenue Code.[30] The enactment of a provision to so adopt future changes in federal law would have raised a question as to the improper delegation of legislative power — a question which had been anticipated in the defeated future adoption bill.[31] Thus by

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[27] *Id.* §§ 220.24(1), 220.33. Because Florida exempts $5,000 from the tax levy for all taxpayers, an expected net income of $55,000 is actually the basis for estimation.

[28] Int. Rev. Code of 1954, § 6154(b).

[29] S.B. 25-D, Nov. Spec. Sess. (Fla. 1971).

[30] Int. Rev. Code of 1954 [hereinafter referred to as the Internal Revenue Code].

[31] *See* A. England, *supra* note 3, pt. 4, for a discussion of the feasibility and advisability of adopting future federal changes automatically, and for the draft legislation which was designed to accomplish that objective.

committee action, the Internal Revenue Code as it existed on November 2, 1971, became the basis of Florida's law.[32] In each committee the decision was motivated by a desire to require the Florida legislature to evaluate, individually, each change that Congress might periodically make in the federal taxation of corporate entities.

Since the legislature's failure to conform Florida's tax law to federal law at frequent intervals could produce significant compliance and audit problems, it is reasonable to expect that the legislature will periodically analyze all changes in the corporate tax provisions of the Internal Revenue Code. In fact this process began at the opening of the 1972 regular session when the Executive Director of the Department of Revenue described to the legislature changes made by Congress subsequent to November 2, in the Revenue Act of 1971, and recommended their immediate adoption in Florida.[33]

2. Consolidated Returns. — A second area in which Florida departed from federal taxation involves the privilege of filing consolidated returns for an affiliated group of corporations. There was very little discussion about consolidated reporting in the legislative process, in part because the subject matter is highly technical and in part because there was little industry opposition to the treatment in the draft statute. In this area, more than in any other, there was strong legislative reliance on staff expertise.

For federal income tax purposes, taxpayers related through stock ownership of at least eighty percent of the voting power of all classes of stock and at least the same percentage of nonvoting shares may file a consolidated return rather than several separate returns.[34] The principal advantage of such filing to a group of eligible corporations is the elimination of tax on transactions between the members of the affiliated group. In theory, the consolidated return provides a basis for taxing the net income earned by members of the group only from sources outside the related group so that no tax is paid on the several levels of net income generated by transactions among the affiliates.

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[32] Fla. Stat. § 220.03(2)(c) (1971).

[33] Letter from J. Ed Straughn to the President of the Senate and the Speaker of the House, January 20, 1972.

[34] Int. Rev. Code of 1954, §§ 1501-05.

The manner of allowing Florida consolidation changed a number of times in the development of the Florida Code, but in each phase it was recognized that Florida's tax law could not fairly mirror the federal treatment of affiliated groups. The interstate and multijurisdictional problems of state taxation seemed to require the creation of a Florida "affiliated group" which would differ from the federal group. As finally adopted, the Florida Code allows any Florida parent of an affiliated group of corporations to file a consolidated Florida return with its in-state affiliates.[35] As a means of accommodating taxpayers desiring to file in Florida on the same basis as they file for federal purposes, the statute also allows a Florida parent and all of its federal corporate affiliates to elect to file their federal consolidated return in Florida, even though some members of the group would not otherwise be subject to tax in Florida.

Many aspects of Florida consolidation have not been resolved in the statute.[36] The legislature intentionally left many specifics of consolidation for treatment in regulations to be promulgated by the Department of Revenue, just as Congress left virtually all aspects of federal consolidation to interpretation by the Treasury Department.

3. *Apportionment.* — Taxation of multistate enterprises in Florida brought about another deviation from federal corporate taxation. In drawing provisions necessary to tax only the Florida-related portion of income earned by a multistate business, legislators were exposed to a facet of state income taxation which most tax practitioners in Florida had never encountered — namely, the methods for determining the portion of federal taxable income properly assignable to one of fifty jurisdictions. Prior to the special session, some members of the legislature had gained some familiarity with multistate tax concepts by attending meetings of national tax groups such as the Multistate Tax Commission. For most legislators, however, income apportionment was a new and highly complex subject. Nevertheless, by the time the Florida Code was finally adopted, multistate income tax concepts had been analyzed in considerable depth and the Legislature of Florida had selected two novel and imaginative concepts for the state.

[35] Fla. Stat. § 220.131(1) (1971).

[36] *E.g.*, methods of apportioning the consolidated properties, payrolls, and sales of multistate enterprises have been left to regulation, although guidelines for types of allowable treatment are set forth in Fla. Stat. § 220.131(5) (1971).

First, the legislature considered whether Florida should differ from the majority of states which tax corporate income by requiring for Florida a full apportionment of the taxable income reported for federal income tax purposes. This treatment of multistate taxpayers differs from the more traditional process of "allocating" — *i.e.* assigning in full — to one jurisdiction some types of passive income, and "apportioning" — *i.e.* assigning proportional shares of income among all the states having jurisdiction over the taxpayer — only the balance. In recent years, some states have departed from the allocation-apportionment format either by statute[37] or by regulatory interpretation.[38] Recognizing that Florida is not the "commercial domicile" for a significant number of multistate enterprises, and being aware that the allocation-apportionment format is financially advantageous only to the few commercial domicile states, the Florida legislature elected to follow the more modern trend to full apportionment.

Prior to the adoption of the Florida Code, Florida had adopted the Multistate Tax Compact which included elective provisions for allocating and apportioning income in the traditional manner under any corporate income tax law which Florida might adopt.[39] To prevent avoidance of the full apportionment provisions, the legislature repealed the conflicting but previously inoperative portions of the Compact.[40]

Secondly, the legislature adopted various methods for apportioning federal taxable income to Florida. For general corporate businesses, the "standard" three-factor formula, which assigns net income among jurisdictions in terms of proportions of sales, payroll, and property, was adopted.[41] The legislature, however, took cognizance of Florida's role as a consumer state. After adopting a pure "destination" test for

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[37] Mass. Gen. Laws ch. 63, § 38.15 (1966).

[38] *E.g.*, Ill. Inc. Tax Reg. § 300-2 (1971), under Ill. Rev. Stat. ch. 120, art. 3 (1969). See also the regulations adopted by the Multistate Tax Commission at its meeting in September 1971.

[39] Fla. Laws 1967, ch. 67-598, *codified as* Fla. Stat. § 213.15, arts. III and IV (repealed 1971). For a discussion of allocation and apportionment, and the Compact, see A. England, *supra* note 3, pt. 2, at 14-16; pt. 6, at 1-3.

[40] Fla. Laws 1971, ch. 71-980.

[41] Fla. Stat. §§ 220.53, 214.71 (1971).

determining the source of sales,[42] the legislature weighted the three-factor formula by assigning fifty percent of the apportionment fraction to sales and twenty-five percent each to payroll and to property. The effect of this variation on the conventional multistate tax practice of assigning each fraction an equal one-third weight is twofold. First, foreign (non-Florida) corporations that sell to Florida's consumer population without locating significant facilities or personnel in Florida will be taxed at a slightly higher level than in other states. Secondly, local corporate businesses that have a substantial physical presence in Florida and have a national market will be subject to a smaller home state tax burden than their counterparts in other jurisdictions. To answer anticipated criticism of the novel Florida apportionment weighting and to avoid possible federal constitutional problems, the legislature added a provision designed to insure against any possible overtaxation by Florida of multistate corporations.[43] The essence of that provision is to allow a tax refund to the extent a taxpayer can prove that the application of Florida's three-factor formula has caused an aggregate levy by all states on more than one hundred percent of federal taxable income, assuming that Florida is entitled to use a 33 1/3 percent weighted sales factor formula.

4. Taxation of Interest Income. — A fourth departure from federal taxability was required by the federal public debt statute.[44] That law prevents state taxation of "all stocks, bonds, Treasury notes, and other obligations of the United States" except to the extent that a state imposes "non-discriminatory franchise or other nonproperty taxes . . . on corporations."[45] Faced with this limitation, the Florida legislature was presented with a number of choices for taxing corporate interest income: (1) taxation of all federal, state, and local interest income; (2) exemption of all such income; (3) exemption of federal interest income only; or (4) exemption of federal and Florida-derived interest income.[46] The one choice that legislators did not have was the form of taxation adopted

[42] The legislature rejected the practice used in many states of taxing so-called "throw-back" sales, *i.e.* sales which originate in Florida but which are not taxed in the state of destination. Fla. Laws 1971, ch. 71-980. For a discussion of throw-back sales see A. England, *supra* note 3, pt. 3, at 2-7.

[43] Fla. Stat. § 220.15(4) (1971).

[44] 31 U.S.C. § 742 (1970).

[45] *Id.*

[46] *See* A. England, *supra* note 4, at 2-10.

for federal purposes. Under the Internal Revenue Code, interest derived from most federal obligations is taxed in full, while interest derived from state and local debt obligations is exempted.[47] Since no state can adopt this method of taxing federal, state, and local interest income without violating the public debt statute, most states have constructed special tax patterns to solve the dilemma and at the same time equitably tax financial institutions, the one type of business most significantly affected by the federal constraint.

The Florida legislature chose to treat banks and other financial institutions like all other entities subject to the Florida tax. Under the Florida Code, as originally enacted, all corporate taxpayers are subject to tax on their interest income derived from non-Florida and non-foreign sources[48] while they enjoy immunity from tax on their federal[49] and Florida state, local, and municipal interest income. The conference committee, however, had discovered that this method of taxation would provide financial institutions with an effective rate of tax significantly less than that imposed on other Florida taxpayers. Accordingly, the conferees specifically identified the possibility of this inequity in their conference committee report and they urged reconsideration of the interest income question at the earliest opportunity.[50] Congress may change the interest immunity provision of the public debt statute,[51] but the Florida legislature has already reconsidered the taxation of interest income. As of this writing, bills to tax financial institutions on all federal, state, and local interest income have been considered by the House Finance and Taxation Committee and the Senate Ways and Means Committee.[52]

Optional Deviations

It was previously indicated that the Florida legislature consciously endeavored to adopt federal corporate taxability as

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[47] Int. Rev. Code of 1954, § 103.

[48] Fla. Stat. § 220.13(1)(a)2 (1971).

[49] *Id.* § 220.13(1)(b)3.

[50] H.R. Jour., Nov. Spec. Sess. 96 (Fla. 1971); S. Jour., Nov. Spec. Sess. 54 (Fla. 1971).

[51] The Federal Reserve Board has already recommended to Congress that this provision be repealed. Report of the Board of Governors of the Federal Reserve System, State and Local Taxation of Banks 7, 11, 66-67 (1971).

[52] H.B. 3653, 3651, and 4323, and S.B. 563, Reg. Sess. (Fla. 1972).

the basis for Florida corporate taxation. There were, however, some areas of taxability in which deviations from federal tax policy were specifically considered and adopted, or seriously considered but rejected.

1. Installment Sale Transactions.[53] — Prior to the November special session, a great deal of time and study was devoted to the difficulties of taxing fairly the income received from installment sale transactions that were consummated prior to November 2, 1971.[54] Dating from the first draft statute released for public analysis on March 8, 1971, this particular subject was discussed in more depth, on more occasions, and among more people than any other subject. In each of the three staff drafts publicly circulated prior to the November referendum, the manner of treating installment sale transactions was different. No one approach to the subject seemed to resolve all of the complaints or problems, and throughout the legislative debates taxation of installment sales remained the most difficult problem to resolve.

The central problem with installment sale transactions stemmed from two sources: Florida's prior constitutional ban on income taxation and Florida's large land sales industry. That industry, uniquely, deals in long-term land sales contracts on which income is reportable for federal purposes on the installment basis. Consequently, in their federal returns these land development corporations will include in post-1971 federal taxable income installment sale receipts from transactions consummated prior to November 2, 1971.[55] Since the occasion for taxability in Florida is the "realization" of income[56] as that term is construed under the Internal Revenue Code, there was

[53] The discussion of installment sales as an optional rather than a mandatory deviation from federal taxation rests on the assumption that the treatment of installment sale income under the third staff draft statute, and under the Florida Code, overcame all constitutional problems arising from Florida's prior income tax prohibition.

[54] *See* A. England, *supra* note 3, pt. 2, at 6-11a.

[55] In legislative deliberations, the problem was almost always discussed as if December 31, 1971 was the date which had given rise to the problem of retroactive taxability. Reference to that date was relevant since all versions of the statute under consideration, including the version finally adopted, called for implementation of Florida's tax system on January 1, 1972. Nevertheless, there was no constitutional problem between November 2 and December 31. The exemption of any income realized during that period is merely a matter of legislative grace.

[56] Fla. Stat. § 220.02(4)(a) (1971).

some question as to Florida's ability to tax, or its justification for wanting to tax, income realized prior to 1972 but recognized in post-1971 years.

In order to avoid constitutional questions, distortion of the tax bases of some industry groups, and major revenue losses to the state, the treatment of installment sale income in the third staff draft statute was drawn to accommodate the realization problem. That draft statute provided that taxpayers electing installment treatment for federal income tax purposes were required to report to Florida under the accrual method of accounting or, at their election, in the same manner as they reported for federal purposes. If the latter method were elected, however, the taxpayer would have had to include in reportable income all collections from transactions which occurred prior to December 31, 1971. While the alternatives of a mandatory accrual method of accounting or an elective installment method were considered by tax technicians to present a legally valid choice, it was suggested that they posed a very difficult choice. One view expressed during legislative deliberations was that such a procedure would force some taxpayers to waive constitutional tax restrictions.[57] Nonetheless, in preserving the parallelism with federal tax reporting and the simplification of compliance and audit techniques, this difficult choice had the practical effect of putting electing corporate taxpayers in precisely the same income position for Florida as they enjoyed for federal tax purposes.

When the House first enacted corporate income tax legislation, the mandatory accrual and the elective installment provisions of the third staff draft were adopted. In the Senate, however, these provisions were amended to exempt from Florida tax all income derived from those contracts consummated prior to January 1, 1972, which had a duration at the time of their consummation of five years or more.[58] This provision, which quickly became identified with the land sales industry, was unattractive to many legislators because it distinguished that industry from others having shorter term installment contracts. A search began for some other method of

[57] It was argued that some taxpayers, finding the accrual method option to their disadvantage, would choose the federal method and thereby subject to taxation income derived from transactions that had taken place prior to the amendment of the Florida constitution.

[58] S. Jour., Nov. Spec. Sess. 21-22 (Fla. 1971).

taxing installment sales that would mitigate the apparent harshness of the House approach, but still deal with all taxpayers uniformly. The approach eventually considered most acceptable to Senate and House conferees was one conceived by House staff to provide relief in direct proportion to the age of installment sale contracts. Transactions consummated in years more remote from the statute's effective date were to be taxed at a lower effective rate than those consummated in years more proximate to that date. The proposal drafted by staff and presented to the conference committee on December 7 would have permitted taxation of ninety percent of all receipts from installment sale transactions consummated in 1971, seventy percent of all receipts from 1970 transactions, fifty percent of all receipts from 1969 transactions, thirty percent of all receipts from 1968 transactions, and ten percent of receipts from 1967 transactions. Receipts from transactions antedating 1967 would have been wholly exempt from the tax. This time-mitigation approach to installment sales quickly gained acceptance among the conferees and other legislative leaders. The idea of subjecting to tax only stated percentages of income was found to be more workable than other possibilities, and debate turned from methods of taxing installment sales to the appropriate degrees of tax immunity.

In its final form, the Florida Code subjects to tax seventy percent of the receipts from installment sale transactions consummated in 1971, fifty percent of such receipts from 1969 and 1970 transactions, twenty-five percent of such receipts from 1967 and 1968 transactions, and ten percent of all receipts from such transactions consummated at any time prior to 1967.[59] Expense deductions, including collection and servicing costs on sales contracts, are allowed only on that portion of income subject to Florida tax.[60]

2. *Operating and Capital Losses.* — Under the Internal Revenue Code, net operating losses and net capital losses give rise to federal tax carryback benefits. Florida was forced to consider a different procedure in order to conform to the state constitutional mandate for an annually balanced budget.[61] Additionally, the constitutional ban on state income taxation prior to November 2, 1971, provided a sound reason to bar the

[59] Fla. Stat. § 220.13(1)(c)5 (1971).
[60] *Id.* § 220.13(1)(c)4.
[61] Fla. Const. art. VII, § 1(d).

use of carryover losses from pre-1972 tax years to offset post-1971 income. To deal with these problems, the third staff draft statute proscribed any carryover of net operating losses from years prior to 1972,[62] and it eliminated loss carrybacks completely.[63]

Both of these provisions emerged from the legislative process intact and now appear in the Florida Code,[64] although both the Senate and House committees originally had voted to allow carryback as well as carryover losses.[65] Under the Florida Code, like treatment is accorded net capital losses and certain other federal carryover deductions. The Florida Code does allow post-1971 operating and capital losses to be carried forward for five years, just as they are carried forward for federal purposes after carrybacks are exhausted. Transitional rules are provided for 1971-72 taxable years.[66]

3. Capital Transactions. — A number of choices were available to the legislature with respect to the treatment of capital gains and losses.[67] Among those considered at various times during legislative debates were the following:

(a) valuation of capital assets as of December 31, 1971, for the purpose of limiting capital gains and losses on such assets to that portion arising after 1971,

(b) ratable monthly proration of the holding periods for all capital assets, for the purpose of mechanically limiting gains and losses on such assets to that portion occurring after December 31, 1971,

(c) taxation of all capital gains, including such gains as might arise from other than capital asset transactions, at a rate lower than that for other types of income, for the purpose of approximating the federal tax maximums of thirty percent on capital gains and forty-eight percent on other income, and

(d) taxation of capital gains at the same rate as all other income.

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[62] A special provision to allow certain carryover losses from pre-1972 taxable years was added by the House for the purpose of alleviating the burden on installment sale income. H.R. Jour., Nov. Spec. Sess. 15-16 (Fla. 1971). This provision was removed by the Senate in the course of granting full tax immunity to contracts having a duration of 5 years or longer. S. Jour., Nov. Spec. Sess. 21-22 (Fla. 1971).

[63] *See* A. England, *supra* note 3, pt. 1, at 8; pt. 2, at 29-31.

[64] Fla. Stat. § 220.13(1)(b)1a, c (1971).

[65] *See* A. England, *supra* note 5, at 4.

[66] Fla. Stat. § 220.13(1)(b)1b (1971).

[67] *See* A. England, *supra* note 3, pt. 2, at 4-6.

In addition to these alternatives, a proposal was considered to value all property as of December 31, 1971, for the purpose of prohibiting taxation on virtually all accruals or accretions of value prior to 1972. This proposal was rejected as being unnecessary to the Florida scheme of taxation, unduly difficult to administer since all types of property would have to be valued as of December 31, and undesirable from a revenue standpoint.

The legislature finally decided to tax all forms of income, including capital gain, at a uniform five percent rate. This decision recognized that Florida imposed a relatively low tax rate in comparison to the federal rate, and that capital asset transactions are usually of limited significance in corporate, as opposed to personal, income taxation. Thus as finally passed, the Florida Code contains no special provision relating to capital transactions. Net long-term capital gain as reflected in federal taxable income is taxed along with all other income at a five percent rate.

4. Small Businesses. — Probably no one subject captured the imagination or dominated the rhetoric of Florida legislators more than the tax treatment to be accorded small businessmen. In the House of Representatives unsuccessful attempts were made to provide all corporate taxpayers with an exemption of $25,000 or $10,000.[68] The House did vote to tax "small business corporations," as they are defined in Subchapter S of the Internal Revenue Code, to the same limited extent that they are taxed at the corporate level for federal tax purposes – that is, only on their extraordinary capital gains.[69]

In contrast to the House treatment of small businessmen, the Senate voted to tax Subchapter S corporations on their entire taxable income in the same manner as all other corporations.[70] The Senate, however, provided some relief for all taxpayers by reducing the tax rate on the first $25,000 of net income to 2½ percent.[71] No effort was made in the Senate to increase the tax exemption beyond the constitutionally required minimum of $5,000.

Because the efforts of some House members to obtain a tax exemption in excess of $5,000 had been defeated, the

[68] H.R. Jour., Nov. Spec. Sess. 18 (Fla. 1971).
[69] *See generally* A. England, *supra* note 3, pt. 2, at 20-27.
[70] S. Jour., Nov. Spec. Sess. 17-18 (Fla. 1971).
[71] *Id.* at 18.

conference committee faced the taxability of small corporate businesses with variances only in the rate structure and the treatment of Subchapter S corporations. A uniform five percent rate of tax was ultimately adopted by the conferees.[72] The Subchapter S question was the last issue that the conferees resolved, and their solution is a model of conference compromise. As finally enacted, the Florida Code provides that for taxable periods commencing before July 1, 1978, Subchapter S corporations are to be taxed on the same basis as they are taxed for federal purposes, as the House had voted. Unless the Florida Code is changed, however, Subchapter S corporations will become subject to taxation like other corporations for all subsequent taxable years, as the Senate had voted, without regard to the election made under the Internal Revenue Code.[73] This provisional exoneration from the tax was designed to insure that the legislature would have ample opportunity to evaluate the federal treatment of these types of corporations for Florida tax purposes.

5. Foreign Source Income. — Income derived from foreign (non-United States) sources was never seriously considered by the legislature to be an appropriate subject for Florida taxation. The draft statutes circulated before the November referendum had raised the possibility of taxing this type of income, but a great outpouring of opposition emanated from areas in south Florida, principally Coral Gables, where there are headquartered export companies doing a substantial business in Latin America, the Caribbean, and other western hemisphere countries. Additionally, several national oil companies urged the legislature to consider the technical difficulties of adjusting the Florida tax base to take into account the foreign tax credit provisions of federal law. It was shown that vast inequities among competing corporations with different corporate structures, but with similar levels of business activity in Florida, would result unless the Florida Code provided something akin to the federal tax credit for foreign source income. A state tax credit did not seem feasible, however.

As finally adopted, the Florida Code eliminates from the tax base all income derived from foreign sources.[74] To prevent erosion of the tax base where domestic as well as foreign source

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[72] Fla. Stat. § 220.11(2) (1971).
[73] *Id.* § 220.13(2)(i).
[74] *Id.* § 220.13(1)(b)2.

income is earned, the apportionment fractions for sales, property, and payroll were adjusted to eliminate foreign property from the denominator of each fraction.[75]

Concluding Observations

The corporate income tax statute of Florida should prove to be a workable law which will not unduly burden state tax administrators or taxpayers. Of prime importance to its feasibility is the fact that the statute parallels federal taxation, almost without exception, as closely as federal law permits. Of secondary importance is the fact that only one of the deviations from federal taxation, an elective provision for installment sale reporting, requires the development of data which is not readily available from the books and accounts presently required to be maintained for federal purposes.

From the state's point of view, the Florida Code is a "clean" statute in the sense that there are few special provisions for particular taxpayers or industry groups.[76] Taxpayers who report income on the installment basis have been given some tax relief for their pre-1972 sales transactions; life insurance companies have been relieved from gross premiums taxes to the extent of income tax payments; and financial institutions have been granted a favored position by reason of the exclusion of all income received from federal and Florida debt obligations. Aside from these items, however, there are no tax credits, special deductions, income exclusions, or industrial allowances. From this point forward, the burden will be on future legislators to maintain the integrity of this statute by resisting inevitable pressures for particularized tax relief.

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[75] *Id.* § 220.15(3).

[76] During the legislative process, efforts were made to obtain tax credits for utilities' gross receipts tax payments, for real property documentary stamp tax payments, and for captial outlays which would qualify for the federal investment tax credit. None of these credits was granted.

Addendum

On March 21, 1972, the Florida House of Representatives passed a bill which made several technical and four substantive changes in the Florida Code.[1] The House bill adopted for Florida the Internal Revenue Code as in effect on January 1, 1972, in order to "update" the Florida Code to include changes made by Congress in the Revenue Act of 1971.[2] The bill subjected to tax in Florida all interest income from federal, state, and local debt obligations,[3] and made permanent in Florida the federal tax treatment of Subchapter S corporations.[4] The bill also provided an election for one special group of taxpayers — contractors — to enable them to report to Florida on the percentage-of-completion method of accounting in cases where they report for federal purposes on the completed contract method of accounting. On March 24 the Senate Ways and Means Committee passed the House bill, with amendments to restore the taxability of Subchapter S corporations after July 1, 1973, and to tax commercial banks at the rate of 2.8 percent of their net income,[5] rather than at the five percent rate. On April 4 and 5 the Senate debated and passed the House bill as amended by its committee;[6] on April 6 the House rejected the Senate's substantive changes.[7] On April 7 the bill was enacted into law with the provisions originally passed by the House.

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[1] H.B. 4323, Reg. Sess. (Fla. 1972); H.R. Jour., Reg. Sess. 814-15, 825-27 (Fla. 1972). See Report of the Finance and Taxation Committee on House Bill 4323 (March 8, 1972).

[2] See pages 11-12 *supra*.

[3] See pages 15-16 *supra*.

[4] See pages 21-22 *supra*.

[5] Based on 1970 figures of the Federal Deposit Insurance Corporation, a 2.8% tax rate on the entire net income of all Florida banks, including interest income derived from state and local debt obligations, would produce the dollar equivalent of a tax rate of 5% on the net earnings of those banks exclusive of the interest which is exempt from federal tax.

[6] S. Jour., Reg. Sess. 799-800, 807, 812 (Fla. 1972).

[7] H.R. Jour., Reg. Sess. 1206 (Fla. 1972).

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: The Gillette Company & Subsidiaries v California Franchise Tax Board
Supreme Court Case No. S206587
Court of Appeal Case No. A130803
San Francisco Superior Court Case No. CGC10495911

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service with postage thereon fully prepaid that same day in the ordinary course of business.

On September 20, 2013, I served the attached **RESPONDENT'S SUPPLEMENTAL REQUEST FOR JUDICIAL NOTICE, MEMORANDUM AND SUPPORTING PAPERS** by placing a true copy thereof enclosed in a sealed envelope in the internal mail collection system at the Office of the Attorney General at 455 Golden Gate Avenue, Suite 11000, San Francisco, CA 94102-7004, addressed as follows:

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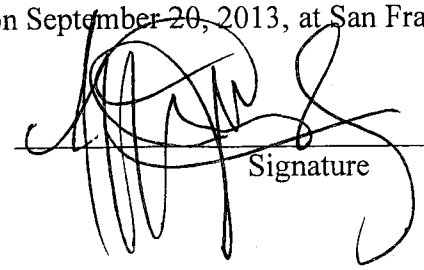
I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on September 20, 2013, at San Francisco, California.

Jacinto P. Fernandez
Declarant



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