STATE OF MICHIGAN
IN THE SUPREME COURT

APPEAL FROM THE COURT OF APPEALS
Krause, P.J. Borello and Riordan, J.J.

INTERNATIONAL BUSINESS MACHINES CORPORATION Plaintiff-Appellant v. DEPARTMENT OF TREASURY OF THE STATE OF MICHIGAN Defendant-Appellee	Supreme Court No. 146440 Court of Appeals No. 306618 Court of Claims No. 11-033-MT

AMICUS CURIAE BRIEF OF

COUNCIL ON STATE TAXATION

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COUNCIL ON STATE TAXATION

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STATEMENT OF INTERESTS OF AMICUS CURIAE

The Council On State Taxation (COST) is a nonprofit trade association based in Washington, D.C. and Sacramento, CA. COST was formed in 1969 as an advisory committee to the Council On State Chambers of Commerce. Roughly coterminous to the State's creation of the Multistate Tax Compact, COST's existence and history has been closely intertwined with the Compact.

Today, COST has grown to an independent membership of more than 600 major corporations engaged in interstate and international business. Member companies of COST are thus representative of that part of the nation's business section which is most directly affected by state taxation of interstate and international business operations. COST is therefore vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty, and fair apportionment of state and local taxes.

COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities, a mission COST has steadfastly maintained since its creation. COST members employ a substantial number of Michigan citizens, own extensive property in Michigan, and conduct substantial business in Michigan.

As *amicus curiae*, COST has participated in several significant United States Supreme Court cases over the past 40 years including *US Steel v Multistate Tax Commission*. Resolving this case requires an appreciation of the historical context in which the Multistate Tax Compact was originally drafted and its intended purpose from the perspective of those who drafted and ultimately enacted it. COST's connection to the Compact and distinctive status representing the taxpayers most directly impacted by State efforts to tax interstate business operations gives

COST a unique perspective. This Brief of *Amicus Curiae* provides the Court with that context and analysis.

Counsel for COST has read the briefings submitted to this Court by the parties to date, and has determined it is important for COST to comment in this matter. COST's *amicus* brief provides missing historical context and analysis, which is critical to an informed understanding of the Multistate Tax Compact and its role not only in securing state sovereignty, but providing a fair and uniform method of apportionment for multistate businesses.

QUESTIONS PRESENTED FOR REVIEW

(1) Whether the Plaintiff (IBM) could elect to use the apportionment formula provided in the Multistate Tax Compact, MCL 205.581, in calculating its 2008 tax liability to the State of Michigan, or whether it was required to use the apportionment formula provided in the Michigan Business Tax Act, MCL 208.1101 et seq.;

Plaintiff-Appellant say "Yes, Plaintiff could elect to use the Compact's apportionment formula."

Defendant-Appellee answers "No, Plaintiff could not elect to use the Compact's apportionment formula."

Court of Claims held "No, Plaintiff could not elect to use the Compact's apportionment formula."

Court of Appeals held "No, Plaintiff could not elect to use the Compact's apportionment formula."

Amicus Curiae Council On State Taxation says "Yes, Plaintiff could elect to use the Compact's apportionment formula."

(2) Whether § 301 of the Michigan Business Tax Act, MCL 208.1301, repealed by implication Article III(1) of the Multistate Tax Compact;

Plaintiff-Appellant answers "No."

Defendant-Appellee answers "Yes."

Court of Claims did not answer.

Court of Appeals answered "Yes."

Amicus Curiae Council On State Taxation answers "No."

(3) Whether the Multistate Tax Compact constitutes a contract that cannot be unilaterally altered or amended by a member state;

Plaintiff-Appellant answers "Yes."

Defendant-Appellee answers "No."

Court of Claims answered "No."

Court of Appeals answered "No."

Amicus Curiae Council On State Taxation answers "Yes."

(4) Whether the modified gross receipts tax component of the Michigan Business Tax Act constitutes an income tax under the Multistate Tax Compact.

Plaintiff-Appellant answers "Yes."

Defendant-Appellee answers "No."

Court of Claims answered "No."

Court of Appeals did not answer.

Amicus Curiae Council On State Taxation answers "Yes."

INTRODUCTION

In 1959, the U.S. Supreme Court decided *Northwestern States Portland Cement Co v Minnesota,* 358 US 450; 79 S Ct 357; 3 L Ed 2d 421 (1959), which for the first time clearly opened up interstate business activities to *fairly apportioned* state taxes. *United States Steel Corp v Multistate Tax Commission*, 434 US 452; 98 S Ct 799; 54 L Ed 2d 682 (1978). The prospect, however, of each state imposing its own method for the apportionment of business activities for state tax purposes was alarming to multistate businesses because that could readily result in double taxation and significant compliance burdens. After an extensive review, congress was poised to step in with legislation imposing a single mandatory apportionment formula which all states would be bound to. The proposed legislation was particularly unfavorable to "market states," i.e., those states that tended to be destinations for sales as opposed to locations for large industrial entities (payroll and property intensive activities).

Rather than face the straight-jacket of congressionally imposed uniform rules for fair apportionment, a number of states banded together and through the auspices of the Council of State Governments drafted an interstate compact, the Multistate Tax Compact (MCL 205.581, the "Compact"). The Council of State Governments, The Multistate Tax Compact - Summary and Analysis (1967)("Compact Analysis"), Att H to Appellant's Br at 4. The State of Michigan "enacted into law and entered into" the Compact in 1970. 1969 PA 343, effective July 1, 1970. The purpose of the Compact was to preserve state tax sovereignty by staving off the federal legislation and foster compatibility of state and local tax systems. *Id.*

At issue in this case is an express provision of the Compact that provides *taxpayers* the option to use either a state's unique apportionment formula or the Compact's uniform method of apportionment.

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such State or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV. [MCL 205.581, art III(1). (Emphasis added).]

The apportionment formula chosen for the Compact was what was then considered the "gold standard" for fair, reasonable, uniform apportionment, the Uniform Division of Income for Tax Purposes Act ("UDITPA").

> "Both within and without those States, this statute [UDITPA] represents the nearest approach to consensus in respect to the allocation and apportionment of income for tax purposes." [Compact Analysis, *supra* Att H to Appellant's Br at 9.]

The beauty of the Compact, from the perspective of the states, is that it gave congressional critics some of what they were looking for (a uniform method of apportionment for taxpayers), while retaining for the states their complete sovereign tax authority – determination of tax base, tax rate, methods of enforcement, and even the right to maintain unique methods of apportionment to encourage economic development.

> The compact would permit any multistate taxpayer, at his option, to employ the Uniform Act for allocations and apportionments involving party states of [sic] their subdivisions. Each party state could retain its existing division of income provisions but it would be required to make the Uniform Act available to any taxpayer wishing to use it. Consequently, any taxpayer could obtain the benefits of multi-jurisdictional uniformity whenever he might want it. [Compact Analysis, *supra* Att H to Appellant's Br at 4 (Emphasis added).]

Even after agreeing to the terms of the Compact, should a state subsequently determine the agreement was no longer in its best interest to be a member of the Compact, a state could simply withdraw from the Compact "by enacting a statute repealing the same," (MCL 205.581, art X(2)), which several states have done. See *US Steel*, *supra* at 454, *noting* Florida, Illinois, Indiana, and Wyoming as having withdrawn. In addition, Nevada (1981 Nev Stat c 181, at 350), Maine (2005 Me Legis Serv c 332 § 29 (West)), Minnesota (HF 677, 2013 Leg 88th Sess (Minn 2013), Nebraska (1985 Neb Laws L B 344, § 9), South Dakota (SB 239, 2013 Leg Assem, 88th Sess (SD 2013)), and West Virginia (1985 W Va Acts c 160) have withdrawn.

The Compact, however, could not fulfill its role of staving off federal preemption if the states could readily abandon it. Congressional demands for uniformity would not be satiated by a model law the states were free to ignore at their convenience. This is what an interstate compact could provide. The promotional materials for the Compact bear out the understanding that the Compact was a true interstate compact and that its terms would be binding on the states that enacted and entered into it.

> With respect to handling significant problems which are beyond the unaided capabilities of the regular constituted agencies of individual state governments, the accepted instrument is an interstate compact or agreement. (citing, among others, The Interstate Civil Defense and Disaster Compact [See MCL 30.261, a non-congressionally approved compact], The Interstate Compact on Juveniles [See MCL 3.701], The Compact for Education [See MCL 388.1301, a non-congressionally approved compact].) [Brochure of the Multistate Tax Compact ("The MTC Brochure"), Appendix Tab A 7ac.]

In 2007, Michigan enacted the Michigan Business Tax Act ("MBTA") MCL 208.1101 *et seq.* which had two components; the Business Income Tax ("BIT") MCL 208.1201 and the Modified Gross Receipts Tax ("MGRT") MCL 208.1203. Plaintiff-Appellant International Business Machines ("Plaintiff" or "IBM") elected to use the Compact's apportionment method for the MBTA. Defendant-Appellee Department of Treasury ("Department" or "Defendant") denied IBM's use of the Compact election. IBM challenged the Department's decision resulting in this litigation.

The Court of Appeal held the MBTA repealed by implication the election provision of the Compact. Appellant's Br. Apx 41a. The Court of Appeals decision, however, is inconsistent with the terms of the Compact, which Michigan continues to be a member of as it has not withdrawn. See MCL 208.581, art X(2). The decision is also at odds with well established compact law which holds that the provisions of an interstate compact take precedence over subsequently enacted, conflicting state laws.

> Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact governs the relations of the parties with respect to the subject matter of the agreement and is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all parties. [*Hellmuth v Wash Metro Area Transit Auth* 414 F Supp 408, 409 (1976).]

The Department argues the Compact is merely a "model law" that does not bind the states that entered into it. Arguing the Compact is merely a "model law" or otherwise not binding on Michigan, the Department fails to heed former U.S. Supreme Court Chief Justice Oliver Wendell Holmes' admonition that "a page of history is worth a volume of logic." *New York Trust Co v Eisner*, 256 US 345, 349; 41 S Ct 506; 65 L Ed 963 (1921). The Compact's history not only illustrates it was intended to be an interstate compact, binding its members to its terms, including the contested election, but the election was a central component to the Compact that kept congressional threats of preemption at bay.

The Department's fallback argument is that Michigan's entry into the Compact in 1970 was void ab initio because entry into the Compact violated the Michigan Constitution. There is no logic to this argument, as no single method of apportionment would be constitutional, including the "single-sales factor" method the Department demands to impose. The Department's final line of defense, should the Court recognize the Compact is a binding interstate agreement on the state is that the MGRT component of the MBTA is not an "income tax" subject to the election provision of the Compact. This argument does not withstand scrutiny when analyzed against the terms of the Compact.

The State of Michigan joined with a number of other states to enact and enter into an interstate compact to provide a mechanism that would allay congressional concerns over state taxation of interstate businesses and avoid federal preemption. The State of Michigan has not withdrawn from that agreement. Allowing the Department to walk away from that obligation because it now finds it inconvenient is contrary to judicial precedent on the application of compact law. Furthermore, a decision upholding the Court of Appeals would threaten the construction and application of other existing agreements Michigan has entered into with other states.[1]

STATEMENT OF FACTS

COST refers this Court to the Statement of Facts and Procedural History in the Brief of Plaintiff-Appellant IBM.

STANDARD OF REVIEW

"Questions of statutory interpretation are . . . reviewed *de novo*." *Grimes v Mich Dept of Transp*, 475 Mich 72, 76; 715 NW2d 275 (2006) (emphasis added). This Court's review of a

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[1] The Council of State Governments "Compact Database" identifies more than 20 interstate agreements Michigan is a party to, http://apps.csg.org/ncic/.

decision to deny or grant summary disposition is *de novo*. *Herald Co v Bay City,* 463 Mich 111, 117; 614 NW2d 873 (2000). Summary disposition should be granted when the affidavits or other documentary evidence demonstrate that there is no genuine issue in respect to any material fact and the moving party is entitled to judgment as a matter of law. *Smith v Globe Life Ins Co,* 460 Mich 446, 454-55; 597 NW2d 28 (1999); MCR 2.116(c)(10). On review of the undisputed facts and questions of law in the grant of summary disposition, the standard of review in this appeal is *de novo.*

In construing tax statutes, any ambiguities must be resolved in favor of the taxpayer. *Michigan Bell Tel Co v Dep't of Treasury,* 445 Mich 470, 477; 518 NW2d 808 (1994). Tax statutes are to be liberally construed in favor of the taxpayer. *Ford Motor Co v State Tax Comm'n,* 400 Mich 499, 506; 255 NW2d 608 (1977). Ambiguities and doubtful language are to be construed in favor of the taxpayer. *Ecorse Screw Machine Prods Co v Michigan Corp & Securities Comm'n,* 378 Mich 415, 418; 145 NW2d 46 (1996). Moreover, tax officials have the burden to identify express language authorizing the tax sought to be imposed. *Standard Oil Co v Michigan,* 283 Mich 85, 88-89; 276 NW 908 (1937).

ARGUMENT

A. THE COMPACT WAS DESIGNED BY THE STATES TO AVOID CONGRESS USURPING STATE TAX AUTHORITY WHILE PRESERVING STATE SOVEREIGNTY.

1. UDITPA's "Gold Standard" for Fair Apportionment Offered an Answer to Congressional Calls for Mandated Uniformity.

During the early years of our Nation's existence, the Supreme Court's view of the Commerce Clause of the U.S. Constitution was one which severely restricted state taxation of interstate commerce. See generally Hellerstein and Hellerstein, State Taxation (3rd ed) ¶4.

> Interstate commerce cannot be taxed at all, even though the same amount of tax should be laid on domestic commerce, or that which is carried on solely within the state. [*Robbins v Shelby County Taxing Dist*, 120 US 489, 497; 7 S Ct 592; 30 L Ed 694 (1887).].

As the twentieth century unfolded, the Court began to waiver from its steadfast prohibition. See *Western Live Stock v Bureau of Revenue,* 303 US 250; 58 S Ct 546; 82 L Ed 823 (1938). At the same time, the Country began to experience a rapid expansion of multistate business enterprises coupled with the growing need for state revenues to finance public services and infrastructure.

The changing economy presented a difficult problem for states and taxpayers alike: how to devise an equitable and constitutional method for taxing corporations that do business in multiple states and countries. By the 1920s, the "unitary" business principle and formulary apportionment, concepts developed with respect to the property taxation of railroads, were being applied in the context of state corporate income tax. See *State R Tax Cases v Secor,* 92 US 575; 23 L Ed 663 (1875); *Butler Bros v McColgan*, 315 US 501, 506; 62 S Ct 701; 86 L Ed 991 (1942) ("We read the statute as calling for a method of allocation which is 'fairly calculated' to assign to California that portion of the net income 'reasonably attributable' to the business done there.")

By the middle of the twentieth century, the need for uniformity among the states to avoid double taxation was evident, but as one commentator notes, the states were not doing anything about it:

> Before 1957, the need for uniformity in state income taxation of multistate businesses was something like the weather -- everybody talked about it, but nobody did anything about it. Then in that year, the Uniform Division of Income for Tax Purposes Act (UDITPA) was born. [Warren, *UDITPA – A Historical Perspective*, 38 State Tax Notes 133 (2005)Appendix Tab H].

Through the auspices of the National Conference of Commissioners on Uniform State Laws (NCCUSL) a model statute was drafted; the Uniform Division of Income for Tax Purposes Act (UDITPA). UDITPA had two main objectives: "(1) to promote uniformity in allocation practices among the 38 states which impose taxes on or measured by the income of corporations, and (2) to relieve the pressure for congressional legislation in this field." Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act, Part I,* 15 UCLA L R 156, Appendix Tab E 68ac-87ac.

UDITPA proposed what was then the "gold standard" of apportionment formulas: the "three-factor" formula of equally weighting property, payroll, and sales. The formula is illustrated for Michigan as follows:

$$\frac{\frac{MI\ Property}{Total\ Property} + \frac{MI\ Payroll}{Total\ Payroll} + \frac{MI\ Sales}{Total\ Sales}}{3} = Michigan\ Apportionment\ Factor$$

The policy rationale behind the three-factor apportionment formula is that equitable division of multistate business activity among states should be based on the factors of production: property representing capital, payroll representing labor, and sales representing the market.

2. The Compact Was An Alternative to a Federally Mandated, National Apportionment Formula.

Just after NCCUSL released the UDITPA model law, the Supreme Court in *Northwestern Portland Cement*, *supra*, for the first time explicitly held there was no Commerce Clause barrier to the imposition of a nondiscriminatory, *fairly apportioned* direct net income tax on an out-of-state corporation carrying on an exclusively interstate business within a taxing state. In upholding the state's net income tax, the Court emphasized requirements that have become modern Commerce Clause jurisprudence: there must be some connection between the state and the taxpayer, the absence of discrimination in the taxing scheme, and *fair apportionment*.

The case produced widespread alarm among businesses.

> There were predictions of the most dire consequences to business and, indeed, the entire nation. Two Senate Committees promptly held hearings, and there was vociferous demand for immediate congressional action. Congress reacted with astonishing speed and, for the first time in its history, adopted an act restricting the states' power to tax interstate businesses. [Hellerstein and Hellerstein, State Taxation (3rd ed), ¶ 6.16. (Underline added).]

Congress immediately enacted Public Law 86-272 (15 USC §381, et. seq.) *limiting* the states' power to tax the net income of multi-jurisdictional businesses. This legislation was not intended to be a permanent solution. Rather, the law served as an effective stopgap while initiating "a comprehensive study of all matters pertaining to the taxation of income derived from interstate commerce." Special Subcomm on State Taxation of Interstate Commerce of the House Comm on the Judiciary, "State Taxation of Interstate Commerce," HR Rep No 1480, 88th Cong, 2d Sess 426–427 (1964), vol 1 at 8 (the "Willis Committee Report")(Att C to Appellant's Br at 3). However, UDITPA was only a model law. While the states touted the uniformity provided by UDITPA, they were nevertheless free to enact whatever parts they thought beneficial or change them entirely. UDITPA, therefore, was "uniform in name only." Dane, *A Solution to the Problem of State Taxation of Interstate Commerce* 12 Vill L R 507, 510. Appendix Tab D 42ac

> Eleven States have adopted what I, perhaps, technically erroneously described in my testimony as the "Uniform Division of Net Income for Tax Purposes Act." I used the term "erroneously" advisedly, because 10 of the States which I had in mind have so substantially varied or changed the provisions in the uniform act that uniformity has been diluted, if not destroyed...Only one State, namely, North Dakota, has really adopted the uniform act. [*Id.* citing a letter from Judge Morgan, of the District of Columbia Tax Court, to a member of the Special Subcom. on State Taxation of Interstate Commerce of the Com. on the Judiciary.]

PL 86-272 was accompanied, however, by a mandate for Congress to study state taxation of interstate commerce and make recommendations to *promote uniformity,* which became known as the "Willis Committee" Report. Among the conclusions of the Willis Committee Report was the existing system of state taxation of interstate business was characterized by substantial inequities for interstate businesses due to inconsistencies in state apportionment formulas and the different definitions of specific factors such as payroll, property and sales. See Dane, *supra*. To solve this problem, the Report called for sweeping federal legislation that would have severely limited state authority to tax interstate business operations and imposed on the states a series of mandates, including a uniform apportionment regime. See Willis Committee Report, *supra*, vol 4 at 1135 (Att E to Appellant's Br at 8); see also, Pomp, State and Local Taxation (6^{th} ed) Ch 11, see Appendix Tab F ac88-101ac.

The Willis Committee's recommendations were incorporated into HR 11798, entitled the Interstate Taxation Act, which was introduced in October 1965. HR 11798, 89th Cong, 2d Sess (1966)(Att F to Appellant's Br). The bill utilized a uniform *two* factor formula (property and payroll) for the apportionment of income leaving out the sales factor included in UDITPA and most existing state apportionment formulae. The consequences for market states (those without large scale industry and manufacturing–payroll and property intensive activities) would have been financially devastating. Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L R 171, Appendix G at 106.

> [A]fter examining the bill's provisions, state tax administrators had real cause for alarm. An immediate reaction was the calling of an unprecedented special meeting of the National Association of Tax Administrators for January 13 and 14 1966, in Chicago. As stated by Mr. Bernard F. Nossel, then Secretary of NATA,

The task faced by the state representatives on January 13th was not merely to express opposition to H.R. 11798, but to oppose it in a constructive manner and to suggest workable alternatives which would eliminate the need for the kind of congressional action embodied in this bill.

It was at this meeting that the idea of a multistate tax compact was envisioned. [Multistate Tax Commission Ann Rep 1 (1968) (Underline added)(Att I to Appellant's Br at 3.]

The Compact was drafted by the states in 1966, presented to legislatures beginning in January, 1967, and became effective, under its terms, on August 4, 1967, when it was enacted into law by seven states. MCL 208.581, art X(1).

"The Compact is the state's answer to Federal control of state taxing policies and programs." The MTC Brochure, supra at 3.

3. **The Election is the Compact's Uniformity Glue Serving to Forestall Congressional Intervention.**

One of the major criticisms of state tax regimes by the Willis Committee Report was the lack of a uniform apportionment formula. The Compact was in large part a reaction to that criticism. Hellerstein and Hellerstein, *supra* at ¶ 9.05.

Lack of uniformity among the business income tax statutes of the various states was the basis of a major business complaint to Congress. The enactment of the Multistate Tax Compact has substantially increased that uniformity in that bodily incorporated into the Compact is the Uniform Division of Income or Tax Purposes Act (UDITPA). [Multistate Tax Commission Ann Rep 3 (1969-1970) at 2 (Att J to Appellant's Br at 7).]

The Compact's election for UDITPA's three-factor apportionment formula was the uniformity glue which bound the states to a uniform apportionment rule. The Commission's own words illustrate the intent:

The Multistate Tax Compact makes UDITPA available to each taxpayer on an optional basis, thereby preserving for him the substantial advantages with which lack of uniformity provides him in some states. Thus a corporation which is selling into a state in which it has little property or payroll will want to insist upon the use of the three-factor formula (sales, property and payroll) which is included in UDITPA because that will substantially reduce his tax liability to that state below what it would be if a single sales factor formula were applied to him; on the other hand, he will look with favor upon the application of the single sales factor formula to him by a state from which he is selling into other states, since that will reduce his tax liability to that state. The Multistate Tax Compact thus preserves the right of the states to make such alternative formulas available to taxpayers even though it makes uniformity available to taxpayers where and when desired. [*Id.* at 3 (Att J to Appellant's Br at 8)(Underline added).]

Thus, while as a member of the Compact Michigan was free to offer an apportionment formula benefiting businesses located in the state, the Compact's central purpose (and the central concern of Congress threatening federal legislation) of having a uniform apportionment method was preserved by giving the taxpayer the option of electing UDITPA and its "uniform" three-factor apportionment formula.

Consistent with the Compact's intent to preserve the right of states to make alternative formulas available to taxpayers, Michigan adopted "single-sales factor" apportionment formula for the MBTA apportioning income entirely on the proportion of sales within Michigan in relation to a company's sales everywhere.[2]

The purpose of the Compact's vesting in taxpayers the option to elect UDITPA's "gold-standard" three-factor apportionment formula, is thus brought into focus. Through the Compact, Michigan is free to exercise its sovereignty and alter its apportionment formula in any manner it chooses (however inconsistent or incompatible it may be with those of other states); a freedom that would not have existed under the proposed federal legislation the Compact was intended to stave off. The Compact requires taxpayers be vested with the option to choose

[2] Alternative formulas were also available under the Single Business Tax Act, former MCL 208.1 et seq.

UDITPA's reasonable, uniform three-factor apportionment formula, thus serving as a floor against the inconsistent apportionment formulas that were Congress' reason d'être for threatening intervention into the state taxation of corporate income. Committing through a collective exercise of sovereign authority, (the Compact) preserved for the states the tax sovereignty that Congress was poised to severely limit.

Forestalling Congressional legislation could not be achieved by the enactment of "model law" because model laws are ultimately ephemeral. The drafters of the Compact understood such, and this is reflected in the materials used to garner support for the Compact to potential member states.

> With respect to handling significant problems which are beyond the unaided capabilities of the regular constituted agencies of individual state governments, the accepted instrument is an interstate compact or agreement. Compact agreements *do* work. [The MTC Brochure, at 10.]

The analysis of the Compact submitted by the Council of State Governments promoting the adoption of the Compact further explains the role of the election and why the Compact was not merely a "model law" as the Department asserts.

> Uniformity in State laws is generally considered to be a desirable objective, but a balance must be struck between a required uniformity and State and local independence. . . States can achieve uniformity by individual and unilateral actions, provided that they enact the same statutes as all other States, keep them uniform after enactment, and administer them in the same ways. An attempt to achieve uniformity by such unilateral action is the 'Uniform Division of Income for Tax Purposes Act' [UDITPA]. . . But even if the recently accelerating pace of Uniform Act adoptions continues, the Multistate Tax Compact can <u>add</u> several highly beneficial ingredients. . .
>
> The first of these may be attributed to the fact that uniformity is not equally important to all interested parties and that its advantages may vary to some extent with circumstances. Uniformity in tax laws is much more of an advantage to certain multistate taxpayers than to the officials of individual States or local governments . . ..

> The Multistate Tax Compact provides that the Uniform Act will be available in all party States to any multistate taxpayer wishing to use it. Consequently, taxpayers will be able to have the benefits of uniformity whenever they want it. On the other hand, States adopting the compact reserve the right to enact any other laws dealing with allocation and apportionment of income that may seem to them to have a special appropriateness or to meet their own policies. [Compact Analysis, *supra* Att H to Appellant's Br at 9.]

The drafters of the Compact clearly intended its terms to be binding on the states that entered into it. The Compact simply could not have achieved its primary purpose of forestalling congressional action but for it being binding, and but for taxpayers being given the option to chose the "gold standard" of uniform, fair apportionment, UDITPA.

B. THE COMPACT IS BINDNG AND SUPERCEDES CONFLICTING STATE LAWS

1. Compacts Are Binding Interstate Agreements.

States create interstate compacts to address shared interests or problems occurring among or in multiple states. The unique characteristic of interstate compacts is they contractually allocate collective state governing authority. They are at once both contracts *and* binding reciprocal state statutes among the parties to the agreement. "When adopted by a state, the compact is not only an agreement between that state and the other states that have adopted it, but it becomes the law of those states as well, and must be interpreted as both contracts between states and statutes within those states." Sutherland, 1A Statutes and Statutory Construction (7th ed) § 32:5 ; see also, *Texas v New Mexico,* 482 US 124, 128; 107 S Ct 2279; 96 L Ed 2d 105 (1987)("There is nothing in the nature of compacts generally or of this Compact in particular that counsels against rectifying a failure to perform in the past as well as ordering future performance called for by the Compact."); *Doe v Ward*, 124 F Supp 2d 900, 914-15 (WD Pa, 2000)("[I]nterstate compacts are the highest form of state statutory law, having precedence over conflicting state statutes. . . Having entered into a contract, a participant state may not unilaterally change its terms.")

> Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact governs the relations of the parties with respect to the subject matter of the agreement and is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all parties. [*Hellmuth, supra* at 409.]

Because compacts represent not only state statutes but reciprocal agreements with other states, the subject matter of such an agreement "is superior to both prior and subsequent law." *Id.* at 409; see also *McComb v Wambaugh,* 934 F2d 474, 479 (Pa 1991)("A compact also takes precedence over statutory law in member states."); *Doe v Ward, supra at* 914-15 ("[I]nterstate compacts are the highest form of state statutory law, having precedence over conflicting state statutes."); *Alcorn v Wolfe,* 827 F Supp 47, 52-53 (D DC 1993)("[T]he terms of [] compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law.") In other words, the decision of the Legislature to enter into the Compact effectively binds subsequent legislatures from enacting laws that impair or alter those obligations piecemeal. *Hellmuth*, *supra* at 409.

The U.S. Supreme Court has long maintained that not every agreement among the states requires congressional consent in order to be afforded the treatment as a compact, binding member states and garnering superior status to subsequently enacted conflicting state laws. *US Steel*, *supra* at 468-72. Nevertheless, "[h]aving entered into a contract, a participant state may not unilaterally change its terms. A Compact also takes precedence over statutory law in member states." *McComb*, *supra* at 479; see also *Virgina v Tennessee*, 148 US 503, 519;

13 S Ct 728, 734; 37 L Ed 537 (1893). Indeed, it appears that no court has ever voided a state agreement or failed to enforce its terms for failure to obtain congressional consent.

2. The Compact Was Considered Binding When Enacted.

The analysis of the Compact by the Council of State Governments (the organization responsible for its drafting) provided to the states to urge their adoption of the Compact makes clear the Compact's election was intended to be vested in taxpayers and *required* to be provided by the member states.

> The compact would permit any multistate taxpayer, at his option, to employ the Uniform Act for allocations and apportionments involving party States or their subdivisions. Each party state could retain its existing division of income provisions, <u>but it would be required to make the Uniform Act available to any taxpayer wishing to use it</u>. Consequently, any taxpayer could obtain the benefits of multi-jurisdictional uniformity whenever he might want it. [Compact Analysis, *supra* at 1 (Att H to Appellant's Br at 4)(Emphasis added).]

The Compact's express terms also illustrate the intent of the drafters that the Compact would be a binding interstate agreement. By its terms, the Compact did not take effect until enacted and *entered into* by seven states. MCL 205.581, art X(1). The Compact is "in force" only in those states specifically providing therefore. MCL 205.581, art VIII. The Compact specific provision for withdrawal requires party states to remain liable for outstanding contractual obligations. MCL 205.581, art X(2). If the Compact operated merely as a uniform state statute or model law it would not need to provide for a method of withdrawal.

California's entry into the Compact is instructive. First, because California had already enacted the UDITPA as a model law, enacting the Compact's virtually identical UDITPA as a "model law" as the Department argues, would have been a superfluous legislative act. See *Hoechst Celanese Corp v Franchise Tax Board*, 25 Cal 4th 508, 518; 22 P3d 324; 106 Cal Rptr 2d

548 (2001) Second, the California legislature took specific steps to shield the state from certain Compact requirements that would not have been necessary if the state did not view the Compact as binding. California entered the Compact in 1974, several years after the Compact became effective. Cal Stats 1974, c 93, Appendix Tab B. The delay in California's enactment of the Compact was partially attributed to California objecting to two provisions of the Compact: (1) Commission actions were approved by one vote per state, substantially diluting California's power in relation to its size; and (2) the Compact provided for the settlement of apportionment disputes by arbitration. To address California's concerns regarding the voting procedures, the by-laws of the Commission were amended to require, in addition to the one vote per state, a weighted vote by population. However, the arbitration clause could not be stricken from the Compact without member states having to re-enact the Compact, as the Compact includes no express provisions for amendment. The solution was the enactment of un-codified statutory language *automatically withdrawing* California from the Compact should the arbitration clause be put into effect or the weighted voting procedure violated. *Id.* § 5 Appendix Tab C 38ac. Thus, if California did not consider the arbitration clause of the Compact potentially binding the enacted automatic withdrawal provisions would serve no purpose. The Legislature is presumed to not engage in idle or superfluous acts. See *Lagden v Concordia Mut Fire Ins Co of Bay, Saginaw, and Arenac Counties*, 188 Mich 689; 158 NW 848 (1916).

3. Department's "History" Does Not Address the Question.

The Department presents the writings of a former Assistant Attorney General for the State of Michigan, William Dexter, to support its argument the Compact was not intended to be a compact or agreement among the states that entered into it. The two arguments the

Department proffers, however, are inapposite to their position. First, Mr. Dexter is quoted as saying "the Commission was only 'an advisory agency and that its work product [was] *not binding on anyone*--State or taxpayer." Respondent's Br at 12 (Italics in original). The argument is a red herring. The Commission, which was created by the Compact (not the other way around), does not make law for the states. The "work product" at issue here is the law passed by the Michigan Legislature, which entered the State into the Compact.

Second, Mr. Dexter is cited for the proposition the Compact is not an "agreement or compact" because "states are free to join or withdraw from the Compact at will." The Department misinterprets Mr. Dexter's words, and alleges that his statement supports the notion that the Compact is not a contract because the withdrawal provision is illusory. This statement is derived from a misunderstanding of the Compact withdrawal provision. The provision states "[a]ny party State may withdraw from this compact *by enacting a statute repealing the same*." MCL 205.581, art X(2) (Emphasis added). Withdrawal from the Compact is conditioned, therefore, on an act, not mere "will." It is hornbook contract law that the performance of an act is a sufficient consideration that supports a contract. Restatement 2d of Contracts, § 72. There is bargained for consideration present here because Michigan has promised to abide by the Compact until such time as the Legislature passes legislation to withdraw from the Compact. *See also* Restatement 2d of Contracts, § 77, illustration 5 (reservation of ability to terminate contract on 30 days notice is not illusory consideration because of the promise to perform until the 30 days elapses).

The Department's citation to *US Steel* is also inapposite. While the Court did recognize the actions of *the Commission* are not binding on the states, that is not the question before this

Court. Rather, the question is whether the *express terms of the Compact* are binding on the states that entered into it. Second, the Court does not refer to the Compact as a "model law" (Department's Br at 14 citing *US Steel, supra* at 454, n 5) in the sense that it was not intended to be an interstate compact. To the contrary, the Court's decision in *US Steel presumes* the Compact is an interstate compact, the nature of which is an agreement to do or not do something according to its terms, otherwise the Court would never have entertained the question of whether the Compact was valid despite its lacking Congressional approval. *US Steel, supra* at 454 ("This appeal requires us to decide whether the Compact is invalid for [it not having received congressional approval.").

4. The Compact Election is Express.

The Department attempts to shoe-horn the Compact into the construct of the U.S. Supreme Court's recent decision in *Tarrant Regional Water District v Herrmann,* __ US__; 133 S Ct 2120; 186 L Ed 2d 153 (2013), by arguing the parties' "course of performance" under the Compact is relevant to interpreting its terms. The Department's reliance on *Tarrant* is entirely misplaced. There was no dispute in *Tarrant* that the Red River Compact ("RRC") at issue there defined the terms of the contract between the signatory states.

> Interstate compacts are construed as contracts under the principles of contract law. *Texas* v *New Mexico*, 482 U. S. 124, 128 (1987). So, as with any contract, <u>we begin by examining the express terms of the Compact as the best indication of the intent of the parties</u>. [*Tarrant, supra* at 2130 (Emphasis added).

The question in *Tarrant* was the construction of an ambiguous *term* of the RRC. In order to interpret terms in the RRC that were unclear, the Court turned to interpretive tools to guide its way, including the parties' course of performance. The Department, however, wants to use "course of performance" to dispute that a contract existed to avoid application of express terms. *Tarrant* is inapposite to such an endeavor.

C. A BINDING COMPACT DOES NOT CONTRACT AWAY MICHIGAN'S TAXING POWER

The Department's fallback argument is that a binding Compact would mean the Michigan Legislature unconstitutionally ceded sovereign power to tax multistate business in violation of Const 1963, art 9, § 2. The thrust of the Department's argument is that Michigan's entry into the Compact was void ab initio under the Michigan Constitution because, by providing an alternative apportionment formula, the Compact necessarily reduced Michigan's tax revenue. Because IBM, by electing the Compact's apportionment provision, paid less tax than it otherwise would have under Michigan's alternative, single-sales apportionment factor, the Department alleges the State has effectively "surrendered" or "contracted away" its taxing power.

The Compact does not affect the state's <u>ability</u> to tax. The Compact does not affect (1) the State's tax *rate*,(2) the composition of the tax *base* (including whether to apply the "unitary" method or separate accounting), (3) determinations of tax *liability*, or (4) *collection* of any taxes determined by a member State to be due.

> [I]ndividual member States retain complete control over all legislation and administrative action affecting the rate of tax, the composition of the tax base (including the determination of the components of taxable income), and the means and methods of determining tax liability and collecting any taxes determined to be due. [*US Steel, supra* at 457.]

The Compact is primarily concerned with apportionment; how business activity is divided among the states having the necessary jurisdiction to tax it. While the Compact allows each member state to define its own apportionment formula, it also requires that taxpayers be provided the option to utilize UDITPA's uniform, fair apportionment method.

Michigan's constitutional proscription against surrendering, suspending, or contracting away the power to tax does not concern itself with procedural hurdles as to the exercise of its taxing power or with the apportionment of tax. Rather, the conditional proscription is concerned with whether the Legislature has ceded power regarding tax rates and the tax base. Section 2 "found its way into the Constitution because in the early history of the State some corporations had been granted special *rates* of taxation." *Harsha v Detroit*, 261 Mich 586; 246 NW 949 (1933)(Emphasis added); *Protect Our Jobs v Board of State Canvassers*, 492 Mich 763; 822 NW2d 534 (2012) (raising the legislative vote threshold to two-thirds for imposing taxes does not abrogate or negate the Legislature's power to tax, it simply requires a different process for exercising that power).

Even if apportionment was designed to be the power of taxation under Section 2, the Department's argument collapses under its own weight. The Department's position is that if the Compact provides a basis for a taxpayer to reduce Michigan's tax revenue then, the Compact conflicts with Section 2 of the state Constitution. *See* Department's Brief at 18 ("If the Legislature had bound itself by contract to grant either other states or private taxpayers the power to elect the three-factor Compact formula, then it contracted away the power of taxation in violation of Const 1963, art 9, § 2"). By the Department's logic, there is *no* uniform method of apportionment that would satisfy Section 2, including the single-sales factor that the Department now defends. For example, a taxpayer with only property and payroll in the State (all sales occurring outside the state) would pay *zero* MBTA to the state, as apportionment would be zero under the single-sales factor apportionment method.[3] The Department's position, therefore, begs the question of which apportionment provision can possibly satisfy their interpretation of Section 2. The Department provides no answer because there is none.

The Department's argument, if taken to a logical end, would require each taxpayer to have a custom-tailored apportionment factor that maximizes the State's post-apportionment tax revenue. Such a mutable, apportionment method would run afoul of the Commerce Clause of the U.S. Constitution, as applying a method of apportionment whose sole aim is to maximize the individual state's revenue without regard to the interstate consequences thereof, is internally inconsistent. *Okla Tax Comm'n v Jefferson Lines*, 514 US 175; 115 S Ct 1331; 131 L Ed 2d 261 (1995). A custom-tailored apportionment formula that maximizes tax revenue from multijurisdictional enterprises is necessarily going to tax greater than 100% of the tax base in contravention of the Commerce Clause. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result."[4] *Goldberg v Sweet*, 488 US 252; 109 S Ct 582; 102 L Ed 2d 607, 261 (1989).

The courts of this state have repeatedly admonished that interpretation of statutes should not lead to absurd results. "Common sense should be employed when construing a

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[3]Perversely, if Michigan had instead adopted the three-factor Compact formula, this hypothetical taxpayer would pay *more* MGRT to Michigan than under single-sales factor apportionment.

[4] For example, suppose that a taxpayer that has $100 in sales in State X, $100 of property in Michigan, and $100 of payroll in Michigan. For Michigan to completely assure itself that it has not "surrendered" its taxing power, it must impose a two-factor apportionment (property and payroll) method in Michigan to capture 100% of this taxpayer's tax base. In State X, the hypothetical Michigan law must be read to impose an apportionment factor strictly based upon sales so that 100% of the tax base is captured there as well. Taken together, Michigan's law, applied across jurisdictions, would capture 200% of the tax base, and is therefore, by mathematical definition, internally inconsistent.

statute. It should be presumed that absurd results were not intended by the Legislature." *People v Meadows*, 175 Mich App 355, 358; 437 NW 2d 405, 406 (1989). Moreover, this Court has reflected that "[s]tatutes are presumed constitutional." *Mich DOT v Tomkins*, 481 Mich 184, 191; 749 NW 2d 716, 721 (2008).

Entering into the Compact did not contract away the Michigan legislature's power to tax. The Department's centerpiece argument fails.

D. THE COMPACT APPLIES TO THE MGRT

The Court of Appeals, in ruling the MBTA repealed the Compact election by mere implication, also raised the question whether the Compact election was applicable to the MGRT component of the MBTA. The Department attempts to establish the Compact does not apply to the MGRT largely by looking outside the Compact itself. The Department's argument that if the MGRT was an "income tax" it would result in double taxation of income, looks to extraneous academic analysis of the MGRT that has nothing to do with the *terms* of the Compact or the purpose of the Compact's election provision. Whether the Compact election applies to the MGRT is determined by the express terms of the Compact. Looking to those express terms as well as the larger purpose of the Compact leads inexorably to the Compact election applying to the MGRT.

1. The Compact Defines "Income Tax" Broadly.

The Compact election is applicable to "[a]ny taxpayer subject to an *income tax* whose income is subject to apportionment and allocation for tax purposes." MCL 205.581, art III(1)(emphasis added). The MGRT is subject to the same apportionment and allocation rules as the business income tax component. MCL 208.1301.

The Compact defines "income tax" very broadly:

> [A] Tax *imposed on or measured by* net income *including* any tax imposed on or measured by an amount arrived at by deducting expenses from *gross income, 1 or more forms of which expenses are not specifically and directly related to particular transactions.* [MCL 205.581, art II(4) (Emhasis added).]

While "a tax imposed on or measured by net income" itself may be sufficiently broad to include the MGRT (See *In re Greektown Holdings, LLC*, __BR__; 2013 WL 2285763 (BR E D Mich, May 16, 2013) "[T]he MGRT is a tax 'measured by income'. . ."). The second clause of this definition unequivocally encompasses the MGRT.

The second clause includes within the Compact's definition of "income tax" a tax "imposed on or measured by" an amount "arrived at by *deducting expenses* from *gross income*, 1 or more . . . of which are not . . . directly related to particular transactions." MCL 205.581, art 11(4)(emphasis added). While the MGRT is generally defined by starting with "gross receipts" as opposed to "gross income," these terms were used interchangeably at the time the Compact was drafted. See Willis Committee Report, *supra* vol 3 at 1014 (discussing the variety of equivalent state taxes imposed on "gross intake" whether labeled "gross proceeds," gross income," or "gross receipts.") (Att D to Appellant's Br at 2). To be included within the Compact's definition of "income tax" therefore requires only that one or more expenses unrelated to specific transactions be permitted. The MGRT allows several such deductions from the equivalent of gross income.

2. The MGRT Is An Income Tax for Purposes of the Compact

The base of the MGRT is generally defined as a taxpayer's "gross receipts" less "purchases from other firms" before apportionment. MCL 208.1203(3). "Gross receipts" is defined broadly as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or others. MCL 208.1111(1). Additionally, the MGRT provides several exclusions from the definition of "gross receipts," among them, amounts deducted as bad debts for federal income tax purposes and net gains on the disposition of certain property included in federal taxable income. MCL 208.1111.

Deductions for "purchases from other firms" include (1) inventory acquired during the tax year, including shipping and engineering charges in the original contract price; (2) assets, including the costs of fabrication and installation, subject to depreciation, amortization or accelerated capital cost recovery for federal income tax purposes; and (3) materials and supplies, including repair parts and fuel. MCL 208.1113(6)(d)-(e).

The MGRT cannot be a "gross receipts tax" as defined by the Compact. Although starting with "gross receipts," the MGRT does not limit the scope of deductions provided to deductions "specifically and directly related to particular transactions." Deductions for assets eligible for depreciation or amortization are clearly not related to particular transactions; neither are materials and supplies, repair parts, or fuel. Because the MGRT provides for deductions not specifically and directly related to particular transactions, by the express terms of the Compact, the MGRT constitutes an "income tax" for Compact purposes.

3. Applying the Compact to the MGRT Is Consistent with the Compact's Primary Objective: Uniform, Fair Apportionment.

At the time of the Compact's formation, states were faced with both opportunity and peril. On one hand, *Northwest Portland Cement* for the first time opened interstate commerce to state income taxes, provided, however, they were "fairly apportioned." *Northwestern*

Portland Cement, *supra* at 460. At the same time, the expansion of states' tax horizons was challenged by congressional legislation intent on setting national standards for apportionment out of concerns over the lack of state uniformity and the potential for double taxation. See generally The Willis Committee Report, *supra* vol 1 at 118-119 (Att to Appellant's Br at 7). The purpose of the Compact was to stave off congressional action by providing the structure of an interstate compact (and ensuring state compliance), while providing a modicum of "fair apportionment" by providing taxpayers the option to choose what was the "gold standard" of uniform, fair apportionment (UDITPA). The election also preserved the states' ability provide to methods of apportionment to enhance local economic activity. See generally Compact Analysis, *supra*; discussion infra Sec. I.A.2)

Viewed in this context, it is only logical that the scope of the Compact's "uniformity" would reach beyond formalistic or academic notions of what constitutes an "income tax". As defined by the Compact, the only "gross receipts" type taxes that would not be subject to the Compact's apportionment terms would be those viewed at that time as not warranting "fair apportionment" in the first place. To find otherwise would permit states, through artful drafting, to circumvent the uniformity requirements of the Compact.

CONCLUSION

The Court of Appeals erred when it concluded the terms of the Compact were subject to unilateral modification by the State of Michigan. The Compact, as a valid interstate compact created a binding agreement among the states party to it, the terms of which take precedence over conflicting subsequently enacted state statutes. Indeed, to function as it was intended–to forestall Congressional action to limit state tax authority and to effectuate what the previously adopted uniformity provisions of UDITPA did not – the Compact must be viewed as binding on

States that enacted it. As a Compact member, the State of Michigan may not unilaterally nullify, revoke, or amend the provisions of the Compact. Absent Michigan's withdrawal from the Compact, it must adhere to its terms, including providing IBM the election afforded taxpayers pursuant to Article III. The Department wants this Court believe it can have it both ways as the State of Michigan continues to be a member of the Compact.[5] It cannot.

For these reasons, amicus COST respectfully requests this Court reverse the decision of the Court of Appeals and permit Plaintiff-Appellant to elect to apportion the MBT according to the terms of the Compact.

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Respectfully submitted,

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[5] See Multistate Tax Commission, *Member States* http://www.mtc.gov/AboutStateMap.aspx (accessed October 30, 2013) and Multistate Tax Commission, *Definition of Member States* http://www.mtc.gov/About.aspx?id=1818 (accessed October 30, 2013) "Compact members are states . . . that have enacted the Multistate Tax Compact into their state law."