Granted

No. 98-2043

IN THE
Supreme Court of the United States

HUNT-WESSON, INC.,
Petitioner,
v.
FRANCHISE TAX BOARD,
Respondent.

On Writ of Certiorari to the Court of Appeal of California for the First Appellate District

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*

Pursuant to Rule 37 of the Rules of the Supreme Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of Petitioner.[1] Tax

[1] Pursuant to Rule 37.6, *amicus* TEI states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Tax Executives Institute has received the written consents of Petitioner and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 5,000 members who represent nearly 2,800 of the leading businesses in the United States and Canada, nearly all of which are engaged in interstate commerce.

The members of the Institute represent a cross-section of the business community in North America. The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the Nation, to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and to vindicating the due process and Commerce Clause rights of business taxpayers.

Tax Executives Institute's members have a vital interest in this case, which involves the unconstitutional effect of the so-called interest-offset rule in section 24344 of the California Revenue and Taxation Code. Many of the companies represented by TEI are directly and adversely affected by the interest-offset rule, which reduces a company's interest expense deduction for each dollar of dividends received from non-unitary subsidiaries. Even those TEI members whose companies are not doing business in California are, almost without exception, engaged in interstate commerce. Consequently, they benefit from, and are entitled to, the positive business environment ensured by the Commerce Clause and Due Process Clause of the United States Constitution.

Because TEI members and the businesses by which they are employed will be materially affected by the Court's decision in this case, the Institute has a special interest in the outcome of this case.

SUMMARY OF ARGUMENT

The question presented in this case is whether the State of California's system of taxation for out-of-state companies violates the Commerce Clause and Due Process Clause of the Constitution. It is well settled that a State may not tax value outside its borders. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog on the mobility of commerce," *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

Like many states, California imposes a corporate franchise tax for the privilege of doing business in the State, using an apportionment formula in respect of corporations with income from sources within and without the State. In calculating a taxpayer's net taxable income, business interest expense is generally deducted from business income. Under section 24344 of the California Revenue and Taxation Code, however, taxpayers must offset their business interest expense—on a dollar-for-dollar basis—with non-business income not allocable to the State. Thus, out-of-state corporations (such as Petitioner Hunt-Wesson) are compelled to reduce their interest deduction by the amount of their nontaxable income, *without regard to whether the interest expense is related to the nontaxable income*. It is this statute that is at issue here.

In this case, the trial court concluded that section 24344 violates the Due Process, Commerce, and Equal Protection Clauses of the Constitution. This latter decision was reversed by the Court of Appeal, First Appellate District, largely on the force of the Supreme Court of California's

1972 decision in *Pacific Tel. & Tel. Co. v. Franchise Tax Board*, 7 Cal. 3d 544 (1972). Subsequent decisions of this Court, however, unequivocally demonstrate that the State's 1972 decision cannot stand. *South Central Bell Tel. Co. v. Alabama*, 119 S. Ct. 1180 (1999); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996); *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93 (1994).

In *Pacific Telephone*, the taxpayer challenged the California interest-offset statute as it applied to nondomiciliary corporations. In reviewing the rule, the California Supreme Court conceded that "when viewed in the light of a *domiciliary* corporation," the rule "does not deprive the taxpayer of any of its interest deduction, but is merely an attempt to provide how the interest expense shall be allocated as between income from operations and income from investments." 7 Cal. 3d at 551 (emphasis in original). The court also commented that the allocation of interest expense is "very favorable" to the domiciliary corporation. *Id.* As applied to out-of-state companies, however, the allocation is manifestly *not* favorable. Hence, on its face, the rule violates the overarching principle of the Commerce and Due Process Clauses that an apportionment formula must, first and foremost, be fair. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983).

Commerce Clause jurisprudence has evolved significantly since California's decision in *Pacific Telephone*. Nowhere has this evolution been more profound than in respect of statutory schemes that facially discriminate against out-of-state commerce. Last term, in *South Central Bell*, this Court invalidated Alabama's franchise tax as facially discriminatory because it gave "domestic corporations the ability to reduce their franchise tax liability simply by reducing the par value of their stock, while it denies

foreign corporations that same ability." 119 S. Ct. at 1185. Five years ago, in *Oregon Waste*, the Court similarly struck down a surcharge on the disposal of waste generated out of state, holding that the taxing scheme was virtually *per se* invalid. *Id. Accord Fulton Corp.*, 516 U.S. at 331.

By its very terms, the interest-offset rule at issue here violates the Commerce Clause. As the trial court found, "the offset provisions treat two corporations in an identical business transaction differently based solely on their state of domicile, which difference results in increased taxes for foreign corporations." (App. at 28a-29a.)[2] Under extant Commerce Clause jurisprudence, the California statute must therefore fall.

The law also offends the Due Process Clause, which requires a minimal connection between the interstate activities and the taxing State, as well as a rational relationship between the income attributed to the taxing State and the intrastate value of the corporate business. *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 772-73 (1992) (citations omitted). California does not contend that the non-business income at issue here bears any relation to Petitioner's in-state activities. Rather, the State seeks to tax Petitioner's extraterritorial activities by requiring a dollar-for-dollar offset of constitutionally protected income against interest expense.

Under *Allied-Signal*, a State may tax dividend income *only* where the payee and payer of the dividend are engaged in a unitary business or the capital transaction serves an operational—rather than an investment—func-

[2] "App." references are to the various appendices bound with the Petitioner's Petition for a Writ of Certiorari to the Court of Appeal of California for the First Appellate District in *Hunt-Wesson, Inc. v. Franchise Tax Board*, No. 98-2043 (filed June 21, 1999).

tion. 504 U.S. at 787. The dividend income sought to be taxed here bears no relationship to Petitioner's in-state activities and thus California's covert attempt to tax it should be rejected as violative of due process.

Moreover, the State's semantics—that the interest-offset rule is not a "tax" and therefore the precedents of this Court are not controlling—cannot change the substance of the statute. It is clear that California could not tax Petitioner's dividend income directly. It is also clear that a State may not, through constitutional alchemy, indirectly tax constitutionally protected income.

In *Allied-Signal*, the Court validated the "necessary limit on the States' authority to tax value or income that cannot in fairness be attributed to the taxpayer's activities within the State." 504 U.S. at 780. The state court did not dispute this holding. Indeed, although rejecting the Petitioner's challenge on *stare decisis* grounds, it acknowledged that "[i]f we were writing on a clean slate, these arguments [against the interest-offset rule] might appear persuasive." (App. at 8a.) This Court can wipe the slate clean by striking down the interest-offset rule because it violates the Due Process Clause of the Constitution.

For the foregoing reasons, the Court should reverse the decision below.

ARGUMENT

I.

The question presented here is whether the State of California's system of taxation for out-of-state companies violates the Commerce Clause and Due Process Clause of the Constitution.[3] That California's taxation scheme can-

[3] U.S. CONST. art. I, § 8, cl. 3 (Commerce Clause); U.S. CONST. amend. XIV, § 1 (Due Process Clause).

not pass constitutional muster was made manifest in this Court's decision in *Fulton Corp v. Faulkner*, 516 U.S. 325 (1996). In that case, the Court examined a North Carolina intangibles tax on the fair market value of stock owned by state residents. Under the state statute, residents owning stock in a corporation earning income solely within the state paid no intangibles tax, whereas residents with stock of foreign corporations having no in-state activities paid the full amount. Because the tax was computed on a different net base depending on the corporation's in-state activities, it was "virtually *per se* invalid." 516 U.S. at 331, 333 & n.3. The same constitutional infirmity characterizes the California tax here.

It is well settled that a State may not tax value outside its borders. *E.g., Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938). Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog on the mobility of commerce," *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

This Court has rightly observed that dividing income among the several States resembles "slicing a shadow." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 192 (1983).[4] Absolute consistency among taxing authori-

[4] The unitary business principle calculates the local tax base by first defining the scope of the unitary business of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of the unitary business between the taxing jurisdiction and the rest of the world based on a formula "taking into account objective measures of the corporation's activi-

ties "may just be too much to ask," *id.*, but there are constitutional limits on a State's use of an apportionment formula, especially in respect of income derived from foreign commerce.[5] In other words, a balance must be struck between the State's need for revenue and the taxpayer's legitimate right to protection from overreaching taxing authorities. It is for this Court to ensure that the balance is a reasonable one. *See Boston Stock Exchange*, 429 U.S. at 329 (the Court has a duty "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers"). If the State has not "given anything for which it can ask return" in respect of the person, property, or transaction it seeks to tax, *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940), the Commerce and Due Process Clauses operate as a constitutional brake upon the State's raw power to tax. The overarching principle of the Commerce and Due Process Clauses is that an apportionment formula must, first and foremost, be fair. *Container Corp.*, 463 U.S. at 169.

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ties within and without the jurisdiction." *Container Corp.*, 463 U.S. at 165. Although the terms "allocation" and "apportionment" are often used interchangeably in respect of the division of income among various jurisdictions, "allocation" properly refers to the "attribution of a particular type of income to a designated state, [and] 'apportionment' refers to the division of the tax base by formula." JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION I: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.01 (3d ed. 1998).

[5] In evaluating challenges to state taxing schemes, the Court examines the practical effect of a challenged tax to determine whether it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

Like many states, California imposes a corporate franchise tax for the privilege of doing business in the State, which is based on the net income derived from or attributable to sources within the State. CAL. REV. & TAX CODE §§ 23151 & 25101 (West 1992). Consistent with the constitutional requirements for corporations doing business both inside and outside the State, taxability of income turns first on the unitary business principle which allocates income to the State—*i.e.*, on whether the out-of-state item sought to be taxed is "unitary" with, or functionally related to, the taxpayer's in-state activities. The amount of operating income earned in California is then determined by calculating the net operating income of the unitary business and apportioning part of it to California by use of a formula.[6] For the years in issue, California used the apportionment formula set forth in the Uniform Division of Income for Tax Purposes Act (UDITPA), which compares (i) the taxpayer's property, payroll, and sales (receipts) within the taxing State to (ii) the taxpayer's total property, payroll, and sales. CAL. REV. & TAX CODE § 25128 (West 1992) (App. at 37a); UDITPA §§ 9-17. "Non-business income"—such as dividends derived from an unrelated business activity—is neither allocated nor apportioned to the State unless the corporation is domiciled there. CAL. REV. & TAX CODE § 25126 (West 1992) (App. at 37a).

In calculating a taxpayer's net taxable income, business interest expense is generally deducted from business in-

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[6] The formulary apportionment of income by a State has been recognized by this Court as a valid means of taxation. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959) ("the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs").

come. CAL. REV. & TAX CODE § 24344(a) (West 1992) (App. at 35a). Under California law, however, taxpayers must offset their business interest expense—on a dollar-for-dollar basis—with non-business income not allocable to the State. CAL. REV. & TAX CODE § 24344(b) (West 1992) (App. at 35a). Thus, out-of-state corporations (such as Petitioner Hunt-Wesson) are compelled to reduce their interest deduction by the amount of their nontaxable income, *without regard to whether the interest expense is related to the nontaxable income*. It is this statute—which increases Petitioner's California tax liability—that is at issue here.

In this case, the trial court concluded on the merits that section 24344 violates the Due Process, Commerce, and Equal Protection Clauses of the Constitution. This latter decision was reversed by the Court of Appeal, First Appellate District, largely on the force of the Supreme Court of California's decision in *Pacific Tel. & Tel. Co. v. Franchise Tax Board*, 7 Cal. 3d 544 (1972). As explained by the Court of Appeal:

> Hunt-Wesson contends that the interest offset provision of section 24344 impermissibly taxes dividends which are constitutionally immune from taxation by California, and therefore violates the federal Due Process Clause. The Due Process Clause limits a state's power to impose a tax on an activity which is not connected with the taxing state. Thus, a state may not constitutionally tax income [from] dividends which a nondomiciliary corporation receives from subsidiary corporations having no other connection with the state.
>
> Hunt-Wesson argues that the interest offset provision of section 24344 constitutes an indirect tax on immune income, increasing a nondomiciliary corporation's tax liability solely because it receives nontaxable dividends. Hunt-Wesson also argues that the interest offset [rule] is overbroad, because it fails to apportion interest expense, but creates a dollar-for-dollar offset. If we were writing on a clean slate, these arguments might appear persuasive. In *Pacific Telephone*, however, the California Supreme Court explicitly held that inclusion of nontaxable dividends in the statutory offset computation under section 24344 does not constitute taxation of the dividends themselves.

(App. at 7a-8a (citations omitted).) The Court of Appeal reached a similar conclusion in respect of Petitioner's argument that the interest-offset rule violates the Commerce Clause, but essentially held that the *Pacific Telephone* decision compelled it to sustain the statute. (App. at 9a-10a.) The California Supreme Court subsequently refused to review the case. (App. at 43a.)

The Court of Appeal's decision flows from the principle of *stare decisis*—unquestioned reliance on the *Pacific Telephone* decision. Subsequent decisions of this Court, however, unequivocally demonstrate that the 1972 decision of the California Supreme Court cannot stand. *South Central Bell Tel. Co. v. Alabama*, 119 S. Ct. 1180, 1185 (1999); *Fulton Corp.*, 516 U.S. at 327; *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 99 (1994). *See United States v. Gaudin*, 515 U.S. 506, 521 (1995) ("*stare decisis* cannot possibly be controlling when . . . the decision has been proved manifestly erroneous, and its underpinnings eroded, by subsequent decisions of this Court.").

II.

The Commerce Clause of the Constitution provides that "Congress shall have Power . . . [t]o regulate Commerce

. . . among the several States. . . ." U.S. CONST. art. I, § 8, cl. 3 The clause not only provides Congress with broad regulatory powers, but also embodies a negative command forbidding States from discriminating against interstate commerce. *Oregon Waste*, 511 U.S. at 98. Its fundamental purpose "is to assure that there be free trade among the several States." *Boston Stock Exchange*, 429 U.S. at 335. To effectuate this purpose, a state taxing scheme will be invalidated if it imposes a higher tax burden on foreign corporations than on domestic corporations engaged in comparable activity. *Id.* at 329 ("[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects" [citations omitted]); *see Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72-74 (1963). Justifications for discriminatory restrictions on commerce must pass the strictest scrutiny. *Oregon Waste*, 511 U.S. at 101.

In this case, the Court of Appeal felt bound by a 1972 decision of the California Supreme Court upholding the interest-offset provision. (App. at 1a.) In *Pacific Telephone*, the taxpayer challenged the California interest-offset statute as it applied to nondomiciliary corporations. In reviewing the rule, the California Supreme Court acknowledged its discriminatory effect on non-residents. Specifically, the State court conceded that "when viewed in the light of a *domiciliary* corporation," the rule "does not deprive the taxpayer of any of its interest deduction but is merely an attempt to provide how the interest expense shall be allocated as between income from operations and income from investments." 7 Cal. 3d at 551 (emphasis in original). The court also commented that

the allocation of interest expense is "very favorable" to the domiciliary corporation. *Id.* As applied to out-of-state companies, however, the allocation is manifestly *not* favorable—a fact known to the State when the interest-offset rule was enacted. *Id.* at 554 (citing a letter by the Franchise Tax Board to the Governor that the rule will "increase taxes on foreign corporations while reducing those of domestic corporations").[7]

Commerce Clause jurisprudence has evolved significantly since California's decision in *Pacific Telephone*. Nowhere has this evolution been more profound than in respect of statutory schemes that facially discriminate against out-of-state commerce. Last term, in *South Central Bell*, this Court invalidated Alabama's franchise tax as facially discriminatory because it gave "domestic corporations the ability to reduce their franchise tax liability simply by reducing the par value of their stock, while it denies foreign corporations that same ability." 119 S. Ct. at 1185. Five years ago, in *Oregon Waste*, the Court similarly struck down a surcharge on the disposal of waste generated out of state, holding that it impermissibly discriminated against interstate commerce because it provided "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." 511 U.S. at 99. Indeed, the Court held that such a scheme was virtually *per se* invalid. *Id. Accord Fulton Corp.*, 516 U.S. at 331 (quoting the "virtually per se invalid" language of *Oregon Waste* in striking down an intangibles tax that was discriminatory on its face).[8]

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[7] The constitutional aspects of the statute were apparently not challenged in *Pacific Telephone*.

[8] Several other decisions of this Court since *Pacific Telephone* also undermine that decision's continuing vitality. *See Camps*

By its very terms, therefore, the California rule violates the Commerce Clause. The trial court here acknowledged the discrimination Petitioner was subjected to: "[T]he offset provisions treat two corporations in an identical business transaction differently based solely on their states of domicile, which difference results in increased taxes for foreign corporations." (App. at 28a-29a.) Hence, if Petitioner's subsidiaries were domiciled in California, they would not face the double taxation effected by the interest-offset rule. Clearly, for some companies enduring the rigamarole of relocating their domicile within the State may be economically worthwhile (compared with the level of double taxation they could avoid), but other taxpayers may not have that flexibility owing to the nature of their businesses or the regulatory regimes in other States.[9] This option, moreover, would not be effective should other States choose to enact similar schemes.[10] More fundamentally, taxpayers should not be forced to jump through

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Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997) (reduction of state property tax exemption for charities operated principally for the benefit of nonresidents is facially discriminatory and thus invalid); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978) (New Jersey law banning waste imported from other States violates the Commerce Clause).

[9] Indeed, even assuming that it would be constitutionally permissible to require taxpayers to establish a separate subsidiary in every State, that option might not be available to some businesses. For example, a transportation company whose assets and employees move across state lines would find it impossible to operate in interstate commerce through a series of domesticated subsidiaries.

[10] In *Container Corp.*, the Court explained that an apportionment formula will offend the Commerce Clause unless it is marked by "internal consistency"—that is to say, unless it is such that "if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." 463 U.S. at 169. The California taxing scheme fails this test because, if other States adopted similar rules, more than 100 percent of Petitioner's income would be taxed.

the hoop of domesticating their business activities or establishing subsidiaries in every State in order to avoid discrimination. *See Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 505 U.S. 71, 78 (1992). Because the Commerce Clause does not afford States leeway to discriminate, the California statute must fall.

III.

The Constitution sets a limit on the power of a single State to tax the multistate income of a nondomiciliary corporation. A minimal connection between the interstate activities and the taxing State is required, as is a rational relationship between the income attributed to the taxing State and the intrastate value of the corporate business. *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 772-73 (1992); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 328 (1982). The Due Process Clause requires that "there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Allied-Signal*, 504 U.S. at 778. In other words, "[o]ne may not be subjected to greater burdens upon his taxable property solely because he owns some that is free." *National Life Ins. Co. v. United States*, 277 U.S. 508, 519 (1928).

In this case, the State of California does not assert that the taxpayer's non-business income bears any relation to its in-state activities. (App. at 16a ("all of the nonbusiness dividends were not taxable by the State of California").) Nor does the State assert a relationship of any great moment between that nontaxable, non-business income and the taxpayer's interest expense. Rather, the State seeks to tax Petitioner Hunt-Wesson's extraterritorial activities by requiring a dollar-for-dollar offset of constitutionally protected income against interest expense. *See Willamette Indus., Inc. v. Franchise Tax Board*, 39 Cal.

Rptr. 2d 757, 760-61 (Ct. App. 1995) (the tax is "exactly the same amount" whether nontaxable dividends are treated as taxable income or are applied against interest expense). Such taxing legerdemain—seeking to do indirectly what it cannot do directly—must not stand.

Under *Allied-Signal,* a State may tax dividend income *only* where the payee and payer of the dividend are engaged in a unitary business or the capital transaction serves an operational—rather than an investment—function. 504 U.S. at 787. Here, the State seeks to rationalize its taxation of dividend income by claiming it is closing a so-called loophole, *i.e.,* that a foreign corporation should not be permitted to borrow money and build up its interest expense deduction and then receive tax-exempt dividends on the basis of investments made with the borrowed money. *Pacific Telephone,* 7 Cal. 3d at 554. A suspiciously similar argument was advanced by the State of New Jersey in the *Allied-Signal* case. There, in seeking to repudiate the unitary business principle, the State argued that multistate corporations regard all their holdings as asset pools and therefore any distinction between operational and investment assets is artificial and should be ignored. 504 U.S. at 784-85. The Court wisely rejected this strained contention, noting instead that the relevant inquiry must focus on "the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *Id.* at 785. The dividend income

U.S. at 327-29. It is also clear that a State may not, through constitutional alchemy, indirectly tax income beyond its jurisdiction. In *Westinghouse Electric Corp. v. Tully,* 466 U.S. 388 (1984), the Court clarified that the denial of a tax exemption (or a deduction) is the economic equivalent of a tax:

> Nor is it relevant that New York discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax. The discriminatory economic effect of these two measures would be identical.

Id. at 404. *See also National Life Ins. Co.,* 277 U.S. at 520 ("What remains after subtracting all allowances is the thing really taxed.").[11] In other words, formal distinctions lacking in economic substance have no constitutional significance. *Westinghouse Electric Corp.,* 466 U.S. at 405. Thus, "[a] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp. v. Michigan Dep't of Treasury,* 498 U.S. 358, 374 (1991) (citation omitted). *Cf. Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n,* 266 U.S. 271, 282-83 (1924) (States' efforts to tax income from non-unitary entities is "a mere effort to reach profits earned elsewhere under the guise of legitimate taxation").

The State characterizes the interest-offset rule as a rational attempt to "correlate expenses between taxable