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OFFICIAL TRANSCRIPT  
PROCEEDINGS BEFORE  
**THE SUPREME COURT**  
**OF THE**  
**UNITED STATES**

CAPTION: HUNT-WESSON, INC. Petitioner v. FRANCHISE TAX  
BOARD OF CALIFORNIA

CASE NO: 98-2043 \

PLACE: Washington, D.C.

DATE: Wednesday, January 12, 2000

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IN THE SUPREME COURT OF THE UNITED STATES

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HUNT-WESSON, INC.

Petitioner :

v. : No. 98-2043

6 FRANCHISE TAX BOARD OF :

## CALIFORNIA :

Washington, D.C.

Wednesday, January 12, 2000

11 The above-entitled matter came on for oral  
12 argument before the Supreme Court of the United States at  
13 11:20 a.m.

14 APPEARANCES:

15 WALTER HELLERSTEIN, ESQ., Athens, Georgia; on behalf of  
16 the Petitioner.

17 DAVID LEW, ESQ., Deputy Attorney General, Oakland,  
18 California; on behalf of the Respondent.

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## PROCEEDINGS

(11:20 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument next in Number 98-2043, Hunt-Wesson v. Franchise Tax Board.

Spectators are admonished, do not talk so long as you're in the courtroom. The Court remains in session.

Mr. Hellerstein.

ORAL ARGUMENT OF WALTER HELLERSTEIN

ON BEHALF OF THE PETITIONER

MR. HELLERSTEIN: Mr. Chief Justice, and may it  
be Court:

This case involves a constitutional challenge to mechanisms that California employs to deny filiary corporations, like petitioner here, an allowable interest expense deduction. Each of hanisms provides an independent basis for ing the application of California statute to f.

First, as respondent has stipulated, California denied petitioner an interest expense deduction entirely because it received nontaxable dividends from nonunitary subsidiaries.

Second, California denied petitioner an interest deduction because those dividends were paid by

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1       subsidiaries that did no business in California. It is  
2       worth stressing at the outset, Your Honors, that the  
3       second mechanism is indistinguishable from the taxing  
4       scheme that this Court struck down in *Fulton Corporation*  
5       *v. Faulkner*.

6                   QUESTION: Well, I suppose we don't have to  
7       answer all the questions here if we were to find that the  
8       interest offset is unconstitutional because it taxes  
9       income over which California lacks jurisdiction to tax.  
10      That's the end of it, presumably.

11                  MR. HELLERSTEIN: That is correct, Justice  
12     O'Connor. Either basis would be -- would invalidate the  
13     statute.

14                  During the tax years at issue here, 1980 to '82,  
15     petitioner Hunt-Wesson, which is the successor in interest  
16     to the original taxpayer in this case, the Beatrice Foods  
17     Company, earned lawfully \$75 million in dividends from  
18     nonunitary subsidiaries. Now, it is undisputed here that  
19     California had no power to tax those dividends under this  
20     Court's decisions in *ASARCO*, and *Woolworth* --

21                  QUESTION: Beatrice was an Illinois domiciliary  
22     the same way Hunt-Wesson is?

23                  MR. HELLERSTEIN: Yes, Chief Justice Rehnquist,  
24     Beatrice was an Illinois domiciliary. Actually, Hunt-  
25     Wesson is a California domiciliary, but they -- again,

1       they were the successor in interest. During the years at  
2       issue we are dealing with an Illinois domiciliary.

3                  Now, during those same years, California denied  
4       Beatrice an interest deduction --

5                  QUESTION: Beatrice, I think. It's named after  
6       a little town in Nebraska, and I think it's pronounced  
7       Beatrice.

8                  MR. HELLERSTEIN: Beatrice. Mr. Chief Justice,  
9       I will pronounce it Beatrice.

10                 (Laughter.)

11                 QUESTION: Smart move.

12                 (Laughter.)

13                 MR. HELLERSTEIN: During these years, Beatrice  
14       received a -- its interest expense deduction was denied on  
15       a dollar-for-dollar basis simply because it received these  
16       nontaxable dividends.

17                 There is no evidence, no evidence at all in this  
18       case that the interest expense bore any relationship to  
19       these dividends. Indeed, even if we had proven -- if we  
20       had proven that every penny of our interest expense had  
21       gone to generate California taxable income, we would have  
22       been denied this interest expense deduction simply because  
23       we had these nontaxable dividends. Now, this --

24                 QUESTION: Let me ask this question. What if  
25       the interest expense had been incurred to generate

1 different nonunitary income. Say you borrowed money to  
2 buy a lot of securities in Japan, whereas the income here  
3 is from income from securities in Germany, would it then  
4 be permissible? Do you understand my question?

5 MR. HELLERSTEIN: I'm not sure. I mean, the way  
6 that --

7 QUESTION: I want to give you a hypothetical in  
8 which the interest expense is incurred to generate  
9 nonunitary income but not the nonunitary -- not the same  
10 nonunitary income that might be earned elsewhere.

11 MR. HELLERSTEIN: Yes, Justice Stevens, I  
12 understand your question, and the answer to your question  
13 is that this statute works regardless of any proof of any  
14 relationship.

15 QUESTION: I understand.

16 MR. HELLERSTEIN: There could be a relationship,  
17 there couldn't be a relationship. It's like throwing  
18 darts at a dartboard.

19 QUESTION: Well --

20 MR. HELLERSTEIN: It might work, might not.

21 QUESTION: Well, maybe in Justice Stevens'  
22 hypothetical it wouldn't be deductible in the first place.

23 MR. HELLERSTEIN: Well, in Justice Stevens'  
24 hypothetical, if we have interest expense, under the  
25 California regime we get the deduction first against any

1 interest, business interest income we have, and then we're  
2 denied the deduction if we have the nontaxable dividends.

3                   QUESTION: But the interest has to be business  
4 interest income, does it not, used for a purpose -- the  
5 money has to be used for a purpose in connection with the  
6 business, or does it not?

7                   MR. HELLERSTEIN: The interest expense that we  
8 have, the interest expense is defined at the Federal  
9 level. We use a Federal taxing scheme, so the Federal  
10 Government does not distinguish between whether or not the  
11 interest expense is business or nonbusiness.

12                  Now, under the California statute and under  
13 their own -- or their own schedule, the very first thing  
14 we do is, we take any interest expense that is, in fact,  
15 attributable to the nonbusiness income, and we take that  
16 out of the mechanism. Then the only thing that is left is  
17 the interest expense associated with the business. It is  
18 that interest expense that in fact is put into this little  
19 mechanism that California has that denies us on a dollar-  
20 for-dollar basis the deduction against the nonunitary  
21 dividends.

22                  QUESTION: Is that the subject of that --

23                  QUESTION: Go on.

24                  QUESTION: Was that the subject of sort of the  
25 disagreement as to whether in fact under the California

1 scheme you are supposed to deduct the nonbusiness income  
2 from -- interest expense from --

3 MR. HELLERSTEIN: That is correct, Justice  
4 Souter. Let me explain that, because there has been a  
5 dispute, and both sides say the dispute doesn't matter.

6 QUESTION: Could you tell me, for --

7 MR. HELLERSTEIN: Yes.

8 QUESTION: -- I was about to ask what you mean  
9 by nonbusiness interest expense. Is it just interest  
10 expense, or nonbusiness income, for that matter? Does  
11 that mean just income that California can't tax, or does  
12 it have some other meaning?

13 MR. HELLERSTEIN: Yes.

14 QUESTION: Let's get a definition.

15 MR. HELLERSTEIN: Okay. Let's start with  
16 nonbusiness income. Nonbusiness income is income that  
17 under this uniform statute that many States have is  
18 allocated, that is, is sent to one jurisdiction or  
19 another, rather than put into this mix that's mixed up and  
20 apportioned. Now --

21 QUESTION: It's really business income that just  
22 can't be taxed --

23 MR. HELLERSTEIN: Oh --

24 QUESTION: -- in this case by California.

25 MR. HELLERSTEIN: Well, let me -- I must be a

1       bit more -- I've got to polish it a bit, because in our  
2       case that's correct. In our case the particular  
3       nonbusiness income we're talking about are nonunitary  
4       dividends, and there's no dispute that California can't  
5       tax that.

6               If, for example, Beatrice had an unrelated  
7       beauty parlour in California, California could have taxed  
8       that. That might be nonbusiness income, but if it was in  
9       California it could have been taxable. But in this case,  
10      there's no distinction. There's no dispute that the  
11      nonbusiness income is not taxable.

12              Now, to answer your question about what is  
13       nonbusiness interest expense, I think we use that term,  
14       and I don't think there'd be any disagreement here, we  
15       would use that term to describe any interest expense that  
16       could be directly traced to the nonbusiness dividends.

17              If, for example -- and there's no evidence in  
18       this case that anything like this happened -- if, for  
19       example, we had gone out and borrowed money to acquire the  
20       nonunitary subsidiaries, and you could trace that  
21       borrowing to the nonunitary subsidiaries, then to be sure  
22       you would have nonbusiness interest expense, and we  
23       would -- our position here is that California could  
24       probably deny that.

25              They could probably deny it if they had a

1 tracing mechanism, which they don't, if they said, we've  
2 seen that you've gone out and you borrowed money to buy  
3 something that's going to generate income that you can't  
4 tax, we accept that. Indeed, we even accept their notion,  
5 which is that it's impossible to trace. All interest is  
6 fungible. All the money is fungible. Who knows where we  
7 use this. Again, we can -- we accept that proposition.

8 The problem is that California statute doesn't  
9 implement that proposition. When, in fact, you don't know  
10 where the interest expense is earned, that is, you can't  
11 do the tracing that we're talking about, what do  
12 jurisdictions do?

13 QUESTION: I'm not sure what you accept insofar  
14 as the fact that all money's fungible and can't be traced.  
15 You say you accept that proposition.

16 MR. HELLERSTEIN: No, what I'm saying is --

17 QUESTION: And that's -- it seems to me that you  
18 might accept that proposition in some instances, but not  
19 in every instance, or then you'd lose your case. Or am I  
20 wrong?

21 MR. HELLERSTEIN: I think, Justice Kennedy, I  
22 don't believe you're right that we'd lose our case,  
23 because we're willing to -- we accept the proposition that  
24 a State can reasonably take the position, and California  
25 in this case could reasonably have taken the position that

1 all money is fungible, and therefore it is impossible ever  
2 to trace on a direct basis a dollar of interest income to  
3 a dollar of interest expense.

4                 But even accepting that proposition, one thing  
5 is clear from -- when you accept that proposition that you  
6 are then saying, you don't know where money is coming from  
7 or going, but then it cannot be -- it cannot be assigned  
8 disproportionately to nontaxable income rather than to  
9 taxable income, so even accepting the notion that money is  
10 fungible, all we're saying -- and we're not saying --  
11 we're not trying to constitutionalize any particular  
12 methodology.

13                 All we're saying is, do what 48 other State, or  
14 45 other States do, do what the Federal Government does.  
15 Spread it around on any of a variety of reasonable bases,  
16 including, if you'll read the letter that California's  
17 already written to General Electric if they lose this  
18 case, spread it around based on where your assets are.  
19 That is, if you don't know where your money's coming  
20 from --

21                 QUESTION: Or deny the deduction altogether.

22                 MR. HELLERSTEIN: Justice Kennedy, if California  
23 wanted to deny all interest deduction to all taxpayers,  
24 whether they had taxable or nontaxable income, we wouldn't  
25 be here. We think that's quite arbitrary. It might no

1 longer be a net income tax, but that's not the  
2 constitutional issue raised by this case.

3                 The problem here is that what California has  
4 done is, under the guise of saying money is fungible, come  
5 up with a mechanism that disproportionately assigns  
6 income, at least in our case, to the nontaxable income, so  
7 based on the undisputed facts of this case, California's  
8 taken the position that somehow we never make a dollar, a  
9 penny -- we never make a penny from interest expense  
10 invested in nonbusiness income.

11                 QUESTION: But if California could deny interest  
12 deductions in toto -- your claim here is more of an equal  
13 protection claim, that you've been treated differently  
14 than other California corporations similarly situated, and  
15 I'm not sure that's made out.

16                 MR. HELLERSTEIN: No, Chief Justice Rehnquist,  
17 our claim is that while we agree that California could  
18 have an across-the-board nondiscriminatory treatment of  
19 interest expense, what California is doing, and the court  
20 below held -- the trial court held they were violating the  
21 Equal Protection Clause, but we've not raised that here.

22                 We're saying that what this does, what this  
23 statute does is two things. First, it sweeps nontaxable  
24 income into the tax base. That's a due process violation.  
25 That's an extraterritorial component. California in fact

1 says that we're going to measure your tax by these  
2 dividends out there that we can't get our hands on under  
3 ASARCO, under Woolworth, number 1.

4 Number 2, we're also -- in our view this also  
5 has a discriminatory component, because when you look at  
6 who gets this interest deduction it's only the domiciliary  
7 rather than the nondomiciliary. As arbitrary as the  
8 statute is, it helps the domiciliary because these -- this  
9 interest expense is always attributed to the nonbusiness  
10 income, which in this case would be taxable by California,  
11 so the nondom -- so the domiciliary gets the full tax  
12 deduction, whereas the nondomiciliary --

13 QUESTION: Oh, I don't see how that helps you.  
14 I mean, I'm not saying that you don't have a good case in  
15 the other part, but I mean, after all, it's an Illinois  
16 corporation. I take it if they allocate all of the  
17 interest income to the Illinois Mongolian sheep farm, that  
18 Illinois, they'll get the deduction on the Illinois income  
19 tax.

20 MR. HELLERSTEIN: No, Justice Breyer, because  
21 Illinois does not have this arbitrary system like  
22 California does. Illinois would take the position that  
23 this -- one of two positions. I'm assuming it could  
24 either trace -- it could say, we're going to directly  
25 trace --

1                   QUESTION: Do you know, does that really happen?  
2     So in other words when California insists that the tin can  
3     business allocates its interest income to its Mongolian  
4     sheep farm, the -- Illinois will not allow them to deduct  
5     that interest expense that California shifted over there.

6                   MR. HELLERSTEIN: That is correct. In other  
7     words -- let me just make sure that I -- I mean --

8                   QUESTION: I'm making up -- what I keep --

9                   MR. HELLERSTEIN: Yes. No, but -- no --

10                  QUESTION: -- is, in my mind I imagine a tin can  
11     company selling all over the United States. It owns a  
12     Mongolian sheep farm.

13                  MR. HELLERSTEIN: Exactly, and --

14                  QUESTION: Okay. Now -- go ahead.

15                  MR. HELLERSTEIN: And therefore the -- this  
16     would -- it would generate nonbusiness dividends.

17     California would say, gee, you have interest equal to  
18     those nonbusiness dividends, no deduction, and then in  
19     Illinois -- then the question would be whether Illinois  
20     would take the same position, and the answer is no,  
21     because Illinois, being a State that is not off the radar  
22     screen like California, but does what other States do,  
23     they'd look at their interest expense, see whether or not  
24     this interest was associated first with the Outer  
25     Mongolian sheep farm.

1           If it wasn't -- if it was, they get the  
2 deduction, because this is a domiciliary State. If it  
3 wasn't, it would go into the pool and they might spread it  
4 around, so that's how it would work.

5           QUESTION: Mr. Hellerstein, your position is not  
6 that California couldn't reject any part of this. It  
7 could have an offset, but it as to be according to some  
8 apportionment, some reasonable apportionment.

9           MR. HELLERSTEIN: That is precisely right,  
10 Justice Ginsburg. Our position is that there are a wide  
11 variety of acceptable methodologies for assigning or  
12 allocating income to various jurisdictions. They're in  
13 place in all of the States, they're in place at the  
14 Federal level, and what we're simply saying is that you  
15 cannot have allocation by wishful thinking, which is  
16 essentially what California has here. It's a simply --

17           QUESTION: What is -- assuming we agree, but  
18 what does California do with respect to these back years  
19 that have already been treated this way?

20           MR. HELLERSTEIN: Well, I can tell you that  
21 our --

22           QUESTION: Can it adopt a, what you would  
23 consider a constitutional rule, and apply them to those  
24 past years?

25           MR. HELLERSTEIN: Justice Scalia, I can only

1 speak to two specific situations that -- one that I'm  
2 aware of because it's our case, another because it's in  
3 the amicus brief. Certainly with regard to our case there  
4 has been -- we have stipulated to the refund to which  
5 we're entitled should we prevail in this case.

6 It was my understanding from -- certainly from  
7 the letter that California has written to General --

8 QUESTION: On the basis of what, some kind of  
9 apportionment scheme that you're willing to accept?

10 MR. HELLERSTEIN: No. The stipulation -- the  
11 stipulation was based on a -- it was an all-or-nothing  
12 proposition. We were going -- there might have been  
13 settlement negotiations earlier, but at this point we  
14 agreed here --

15 QUESTION: You'll get it all back.

16 MR. HELLERSTEIN: If we win.

17 QUESTION: And it's too late for them to say,  
18 okay, we'll apportion some of it. They -- none of it  
19 would be --

20 MR. HELLERSTEIN: For these particular years,  
21 that is correct, Justice Scalia. However, I think it's  
22 quite clear, from the letter appended to the General  
23 Electric's brief, that California is aware of this  
24 litigation, they have written letters to General Electric  
25 and presumably to other taxpayers saying, and by the way,

1 if we lose this case, you'd better apportion your interest  
2 expense by a reasonable amount, namely an asset allocation  
3 method, so I --

4 QUESTION: Well, on that basis maybe you could  
5 help me understand what the State says in its red brief at  
6 page 21.

7 It says, if a deduction of the entire amount of  
8 interest expense is allowed, the corporation stands to  
9 gain a tax windfall, and then it goes on. I take it  
10 that's only because California does not have an  
11 apportionment system in place, is that correct?

12 MR. HELLERSTEIN: I think frankly --

13 QUESTION: I mean, is that the way you would  
14 answer that? You'll say, well, sure, but if you have an  
15 apportionment scheme in place like other States do, there  
16 won't be a windfall. Is that how you answer that?

17 MR. HELLERSTEIN: Actually, Justice Kennedy, the  
18 way I would answer that, I think that's because of  
19 California's Californiacentric view of the universe. In  
20 fact, there is no windfall, because Beatrice pays taxes in  
21 45 other States, so that the -- any income -- we're not  
22 talking about tax exempt municipal bonds here. I mean,  
23 income that California says is not taxable in California  
24 because it's not a unitary -- part of the unitary business  
25 is presumably taxable somewhere else.

1           The only time there would be a windfall would be  
2       if the income that California is not taxing under a proper  
3       scheme is somehow not taxed by the other jurisdiction.

4           QUESTION: Well, is the answer there wouldn't be  
5       a windfall if there were an apportionment scheme? Would  
6       you accept that answer?

7           MR. HELLERSTEIN: I would certainly accept that  
8       if California apportioned in the way that other States  
9       apportioned, there would be no windfall, that is correct.

10          QUESTION: But you don't intend, do you,  
11       Mr. Hellerstein, that California has to have the same  
12       method of taxing that -- even if 48 other States have it,  
13       the Constitution doesn't require them to have --

14          MR. HELLERSTEIN: Absolutely not, Mr. Chief  
15       Justice. Absolutely not. We are saying that there are --  
16       we are saying that their method is so far off the radar  
17       screen, is so different from any method that even  
18       approximates a reasonable method, and there are a large  
19       variety of them, whether it's assets or gross receipts or  
20       net income, any of those would be appropriate.

21          Indeed, to look at this Court's own opinions,  
22       this Court has looked at this problem in a number of  
23       instances, generally when the question was whether or not  
24       a taxpayer, or how a taxpayer should attribute expense  
25       between taxable income and tax exempt income, generally

1 either municipal bond income that wasn't taxable at the  
2 Federal level, or alternatively, Federal taxable income  
3 that wasn't taxable by the States, and what the Court has  
4 said -- when the Court has looked at this, the Court has  
5 really rejected both extremes.

6                 The Court has rejected the extreme view of the  
7 States, which has been to say -- or the taxing authority,  
8 when the taxing authority has said, you may not deduct  
9 1 penny of this expense -- that is, the expense must be  
10 matched dollar-for-dollar against the tax-exempt income,  
11 which is what the -- the kind of situation that arises in  
12 National LIfe, the Court said, you can't do that, because  
13 that really undermines the exemption.

14                 On the other hand, when taxpayers have been  
15 greedy, when taxpayers have said, we don't want \$1 of our  
16 expense assigned to our nontaxable income, because that  
17 undermines the exemption, the Court has said no, that's  
18 not right, either.

19                 What the Court has said is really precisely what  
20 most States and the Federal Government have said in this  
21 kind of situation, is when you don't know, when you can't  
22 trace the amounts, what you do is, you spread it evenly.  
23 This Court has said, there's no reason in law, or no sound  
24 legal or economic reason for distinguishing between the  
25 taxable and the nontaxable dollar. That's the theme. So

1 long as there is some reasonable apportionment between  
2 taxable and nontaxable, that, I think, is all the  
3 Constitution requires.

4 What the Constitution forbids is a  
5 disproportionate assignment of income to values that  
6 cannot be taxed.

7 QUESTION: Can you -- because I'm not totally  
8 familiar. Which part of the Constitution forbids that?

9 MR. HELLERSTEIN: Forbids --

10 QUESTION: I mean, let's assume you're  
11 completely right.

12 MR. HELLERSTEIN: Right.

13 QUESTION: This is totally irrational. I mean,  
14 it's completely unfair. They're taxing income that arises  
15 in other places. What is -- what -- can you just trace  
16 through for 1 second what the argument is that that  
17 violates the Constitution?

18 MR. HELLERSTEIN: Yes, Justice Breyer. It will  
19 depend on --

20 QUESTION: I know there will be cases that  
21 support you, but I mean, what's the reasoning?

22 MR. HELLERSTEIN: Well, I guess, you know, it  
23 would depend on the provision. Well, the basic thought is  
24 that by arbitrarily denying the deduction you are taxing  
25 the income, so --

1                   QUESTION: And what prevents California from  
2 taxing income from Mongolia, or Illinois or something?

3                   MR. HELLERSTEIN: The Due Process and the  
4 Commerce Clause, as this Court has held in Allied-Signal  
5 and ASARCO and Woolworth. In the intergovernmental  
6 immunities cases, that is, when we're dealing with --  
7 let's deal with the modern cases. We're dealing with  
8 State taxation of Federal obligations such as in the  
9 Barker Bank case. There, Georgia would have been  
10 forbidden under the -- under McCullough v. Maryland, but  
11 as embodied in, know in Federal statutes from taxing the  
12 Federal income. Some of the earlier cases are based on  
13 the --

14                  QUESTION: But the Federal principle that a  
15 State can't tax a Federal entity wouldn't necessarily  
16 carry over if you weren't dealing with a Federal entity.

17                  MR. HELLERSTEIN: Well, Chief Justice Rehnquist,  
18 the way the cases have arisen with regard to that issue,  
19 that is, it is a given proposition of -- I think of  
20 Federal constitutional law and also valid Federal  
21 statutory law that States may not tax income from Federal  
22 obligations, so a State, for example, could not come along  
23 and deny, as California has denied, an interest expense  
24 deduction arbitrarily assigned to every dollar of Federal  
25 income that it can't tax.

1                   QUESTION: Yes, but income from a Federal  
2                   obligation may be different for constitutional purposes  
3                   than income from some other kind of obligation.

4                   MR. HELLERSTEIN: That is correct. That is  
5                   correct.

6                   QUESTION: And so what is it that -- one day  
7                   California says, you know, we're taxing people. We don't  
8                   want to be fair, and what we're going to do is, we are  
9                   going to tax income that arises in Illinois, and moreover,  
10                  it's going to be terrible, because companies are going to  
11                  have to pay more tax than they have income.

12                  QUESTION: Well, I thought we'd held in Allied-  
13                  Signal that it violates the Due Process Clause --

14                  QUESTION: That's what I wondered.

15                  QUESTION: -- for a State to tax --

16                  QUESTION: It's the Due Process Clause that it  
17                  does that --

18                  QUESTION: Extraterritorial --

19                  QUESTION: -- because it takes their property  
20                  without due process.

21                  MR. HELLERSTEIN: It is both, indeed, as Justice  
22                  O'Connor was pointing out, and in Allied-Signal the Court  
23                  said that the extraterritorial analysis, or the bar on  
24                  State taxation of extraterritorial values is rooted both  
25                  in the Due Process and the Commerce Clauses, so you'd have

1 two constitutional bases for that.

2                   QUESTION: Well, what about the argument that,  
3 indeed, your client is getting a windfall because home  
4 States like Illinois give a tax break for this category of  
5 investment income?

6                   MR. HELLERSTEIN: Well, in fact, Justice  
7 Ginsburg, Illinois is not a tax haven, and during the  
8 years at issue here, the -- and this -- by the way, these  
9 were years during which there was considerable uncertainty  
10 as to whether or not income was apportionable. There were  
11 the -- this Court -- some members of this Court will  
12 recall the ASARCO and Woolworth and container cases in the  
13 eighties, where there was uncertainty.

14                  Illinois had a regulation at that -- during  
15 those years that actually allowed a domiciliary  
16 corporation like Beatrice, and the regulation is 300-  
17 2(c)(2)(A), that during those years allowed a domiciliary  
18 corporation to apportion its income.

19                  Now, that was a decision made by Illinois.  
20 Illinois had the constitutional power, and indeed our --  
21 it is stipulated in the -- it's -- I believe it's  
22 stipulation, paragraph 8. It's stipulated that nonunitary  
23 dividends were taxable by the State of Illinois, so  
24 there's no windfall tax haven issue here. In fact --

25                  QUESTION: You don't think that matters, though,

1 do you, anyway?

2 MR. HELLERSTEIN: No.

3 QUESTION: If Illinois decides to be generous  
4 and not tax something, California, if it has no  
5 jurisdiction to tax, can say, hey, you know, somebody's  
6 getting a break. We ought to be able to reap that tax.

7 MR. HELLERSTEIN: That --

8 QUESTION: It would still not be -- not be  
9 justified.

10 MR. HELLERSTEIN: That is precisely right,  
11 Justice Scalia. California's power to tax does not expand  
12 based on Illinois' decision whether or not to tax. We'd  
13 have -- I'd like to reserve the next 5 minutes for  
14 rebuttal. Thank you.

15 QUESTION: Very well, Mr. Hellerstein.

16 Mr. Lew, we'll hear from you.

17 ORAL ARGUMENT OF DAVID LEW  
18 ON BEHALF OF THE RESPONDENT

19 MR. LEW: Mr. Chief Justice, and may it please  
20 the Court:

21 I think the issue before this Court can be  
22 simply stated, and that is, what interest expense is  
23 California constitutionally required to treat as a tax  
24 deduction?

25 As this Court has held, a State bears no

1       constitutional obligation to permit a taxpayer to take a  
2       deduction for an expense which relates to income which  
3       that State is barred from taxing. The petitioner in this  
4       case has conceded that States such as California have the  
5       constitutional authority to allocate expenses to different  
6       streams of income and, more importantly, concedes that  
7       States have the authority to do so by applying formulas  
8       that assign interest expense to income that is not taxable  
9       by the State of California.

10                  The petitioner's narrow --

11                  QUESTION: Yes, but the problem here is,  
12               California has chosen to allocate 100 percent of the  
13               taxpayer's interest expense in excess of its business  
14               interest income to its generation of nonbusiness income  
15               that's not taxable by California.

16                  MR. LEW: Well, the --

17                  QUESTION: I mean, it's California's choice to  
18               have this scheme, and it's enacted one that does raise  
19               concerns of trying to tax extraterritorial income, in  
20               effect. I mean, California wouldn't have to do it this  
21               way. California could have a reasonable allocation  
22               method. But what's the rationale for this scheme it does  
23               have, which just seems to go beyond what California is  
24               authorized to do?

25                  MR. LEW: Well, the answer to your question,

1 Justice O'Connor, is that what California is trying to do  
2 with this statute is basically eliminate a double tax  
3 benefit that arises whenever a corporation, number 1,  
4 incurs debt, and there is therefore interest expense  
5 generated by that debt, and at the same time has funds  
6 invested in nontaxable activities which produce nontaxable  
7 income.

8                 The problem is that part of the debt either  
9 directly or indirectly is used to support the nontaxable  
10 activities.

11                 QUESTION: But you solved that problem by  
12 denying it against all nonunitary income whether or not  
13 the interest expense was related to it.

14                 MR. LEW: Well, what the statute is attempting  
15 to do, Justice Kennedy, is to essentially close that  
16 loophole in the most effective way possible.

17                 QUESTION: Well, of course, it's always  
18 effective if you deny apportionment.

19                 MR. LEW: Well, the theory behind doing it on a  
20 dollar basis -- and if I may just take one step back. The  
21 formula first allocates interest expense to -- against the  
22 corporation's business interest income on a dollar-for-  
23 dollar basis.

24                 QUESTION: And if the business interest is big  
25 enough, then there's going to be no problem.

1                   MR. LEW: That's correct. All of it is -- all  
2 of it is deductible.

3                   QUESTION: Of course.

4                   MR. LEW: To the extent that any remains, that  
5 is allocated also on a dollar-for-dollar basis against the  
6 corporation's nonbusiness income, and again it's intended  
7 basically to eliminate the possibility that any amount of  
8 that interest expense which is related to the generation  
9 of income that's not taxable by the State of California is  
10 used by the corporation to reduce its California tax base.

11                  QUESTION: Yes, but it's not allocable against  
12 all its nonbusiness income.

13                  MR. LEW: It's -- well, the answer to your  
14 question is, it's allocable against its nonbusiness  
15 interest and dividend income. That's what the statute  
16 calls for.

17                  QUESTION: My can company has no business  
18 interest income. It's not in the lending business. It  
19 sells \$1 million worth of cans in California. It happens  
20 to borrow about \$900,000 to get the tin. Now, what  
21 conceivable reason does California have to allocate that  
22 \$900,000 that they used to buy the tin for the cans to  
23 some kind of income it has from the sheep farm in Florida?

24                  MR. LEW: Because the money that is borrowed  
25 basically is -- can't -- is used to free --

1                   QUESTION: Say you don't know. Maybe they're  
2 lying. They said they used it for tin, but maybe they're  
3 not telling the truth. Okay, other States have dealt with  
4 that problem by saying, since we can't trust anybody here,  
5 and it's hard to trace, what we'll do is, we will  
6 proportionately allocate. If you have a million coming in  
7 from the tin business, and you have 100,000 from the sheep  
8 farm, do it 10 percent to the sheep farm, 90 percent to  
9 the tin.

10                  All right. Now, why -- what possible reason is  
11 it for not taking some variation on that theme? Of  
12 course, if you can show it went to the sheep farm, that's  
13 the end of it. You win. But where you just don't know --

14                  MR. LEW: There's nothing wrong with a  
15 proportional approach, Your Honor, except that it doesn't  
16 really close the loophole.

17                  QUESTION: How does it not close the loophole?

18                  MR. LEW: Because to the extent that less than  
19 \$1 of interest expense is used to offset a dollar of  
20 nonbusiness income, there's still that differential that  
21 exists.

22                  QUESTION: Sure there's a differential, but the  
23 sheep farm had nothing whatsoever to do with the lending.

24                  MR. LEW: Well --

25                  QUESTION: I mean, I don't see why you call that

1 a loophole.

2 MR. LEW: The assumption is that it's not  
3 related, and --

4 QUESTION: Yes, right. Oh, you mean maybe it is  
5 related?

6 MR. LEW: Indirectly, yes.

7 QUESTION: Well, maybe the tin is really  
8 related, so why don't you allocate all the deduction for  
9 the tin to the sheep, too?

10 MR. LEW: Well, the answer is that you just  
11 don't know that, and what -- and what California is trying  
12 to do is to prevent any of that interest that might be  
13 related to the generation of income that it cannot tax to  
14 be used to reduce its California tax base.

15 QUESTION: Well, when you say they just don't  
16 know, what you're referring to is the -- a process in  
17 which most States know by virtue of a reasonable  
18 apportionment formula, and so when you say, well, we just  
19 don't know, that seems to be the equivalent of saying,  
20 well, we can't apportion, but you clearly can.

21 MR. LEW: Well, there's no problem,  
22 constitutional problem with apportionment. I mean, that  
23 is one way to deal with the problem for sure, but to the  
24 extent that interest in fact does relate to nonbusiness,  
25 or nontaxable income, there's still that -- there's still

1       that possibility that a portion of the interest expense  
2       that in fact relates to generation of nontaxable income is  
3       going to be applied to reduce the corporation's California  
4       taxes.

5                   QUESTION: Yes, but you don't know either, and  
6       instead of adopting an apportionment formula, what you in  
7       effect do is adopt an irrebuttable presumption, and as  
8       against an apportionment formula, which provides a  
9       rational basis, and an irrebuttable presumption which  
10      ignores the facts, due process normally requires the  
11      rational process.

12                  MR. LEW: Well, I can only say that the  
13       objective of the State is to attempt to eliminate that  
14       possibility of the taxpayer receiving a double tax  
15       benefit.

16                  QUESTION: Oh, you certainly do that.

17                  QUESTION: Yes.

18                  (Laughter.)

19                  QUESTION: No question.

20                  QUESTION: You achieve that objective.

21                  (Laughter.)

22                  MR. LEW: And toward that objective it seems  
23       that the way that California does it is reasonable,  
24       because a dollar-for-dollar offset of interest expense and  
25       interest or dividend income basically returns the

1 corporation to the same economic position --

2           QUESTION: Well, it does if there's a dollar-  
3 dollar relationship between the expense and the income,  
4 and you're in effect saying, we don't care. We will  
5 simply assume that, and we will assume that by means of  
6 this presumption, and due process requires rationality,  
7 not irrebuttable presumptions.

8           MR. LEW: Well, you know, we can't say that it  
9 does or it doesn't. That is --

10          QUESTION: But you have to say that it does.  
11 You don't have a right to send a tax bill to every  
12 nondomiciliary of California for all of their income, and  
13 you say, well, you know, we can't be sure that we can't  
14 tax it.

15          (Laughter.)

16          QUESTION: It's just irrational. You either  
17 demonstrate that it comes from this other nontaxable  
18 income, or -- or, if you can't demonstrate it, then, you  
19 know, do a reasonable apportioning, but you do neither  
20 one. You're just saying, here, here's a tax bill, pay it,  
21 or we're not sure where this income comes from, but we  
22 don't want you to get away with something.

23          MR. LEW: Well, it seems to me that the economic  
24 reality -- the dollar-for-dollar allocation is really an  
25 attempt to reflect the economic reality that interest

1       income is the economic counterpart to interest expense.

2       If a corporation borrows money --

3                    QUESTION: If you treat the interest as paid --  
4       say you have a mortgage on a new plant that you're using  
5       in California. You treat it as the functional equivalent  
6       of interest to buy securities in Mongolia that are going  
7       to have nothing to do with the unitary business. You just  
8       merge all of your interest income and treat it as  
9       fungible.

10          MR. LEW: That's --

11          QUESTION: Your interest expense, I mean,

12          MR. LEW: That's correct.

13          QUESTION: Yes, and notwithstanding the fact  
14       that it's very easy to identify that in fact some of the  
15       income produced by those borrowings is not part of the  
16       unitary business.

17          MR. LEW: Well, I think that if the Court  
18       accepts the notion of fungibility, then the problem is  
19       being --

20          QUESTION: If it wasn't spent there, it could  
21       have been spent elsewhere, so it's hard to say that it  
22       necessarily went to this. It's saving you spending other  
23       money elsewhere. Of course, that's true.

24          MR. LEW: That's correct.

25          QUESTION: But if you adopt that fungibility

1 principle, which your opponent is quite willing to accept,  
2 what it leads to is not the conclusion that you can tax  
3 all of it, but the conclusion that you should apportion  
4 it.

5 MR. LEW: Well -- well, I disagree with the idea  
6 that it is being taxed. After all, the formula itself  
7 allows as a first step an allocation of interest expense  
8 against a corporation's business interest income, so to  
9 the extent that the amount of business interest income  
10 is -- swallows up the entire amount of the expense, then  
11 all of it is allocated to reduce the corporation's  
12 California taxes.

13 QUESTION: I don't see what that -- I mean, most  
14 businesses, except if they're in the financial business,  
15 don't have a lot of business interest income compared to  
16 their other business, so I don't think that helps too  
17 much, does it?

18 MR. LEW: Well, I think it -- I think it  
19 demonstrates that the statute applies its rules in a fair  
20 and even-handed way. I mean, certainly it is possible  
21 under California's statute for a corporation to come out  
22 better than it would under a proportional approach, and I  
23 think that that is one of the things that has to be  
24 understood, that the statute does allocate interest  
25 expense to interest income and dividend income in a fair

1 and in an even-handed basis. In fact, the first step of  
2 the statute allocates it to business interest income.

3                 And with regard to the -- what the statute does,  
4 it basically shifts those deductions which it considers to  
5 be attributable to nontaxable income to the -- it  
6 attributes it to the income which is then taxed -- which  
7 is then allowed as the deduction by the State of domicile  
8 if, in fact, that State utilizes a statutory scheme which  
9 is similar to California's.

10               Now, it is true that none of the other States  
11 currently adopt such a provision, but under this Court's  
12 internal consistency analysis I'm not sure whether or not  
13 that's a constitutionally significant point. If in fact  
14 it were the case that all of -- that all States utilized  
15 this formula, then the taxpayer would be able to have the  
16 benefit of all of the deductions which California has  
17 essentially shifted over to the State of domicile and  
18 enjoy a reduction in its nonbusiness income in that State.

19               It -- the statute simply attempts to assign  
20 interest expense to its proper use or application, and it  
21 does so on a dollar-for-dollar basis against its business  
22 income and against the corporation's nonbusiness income.  
23 In that sense, it is applied even-handedly, and again,  
24 those deductions would be available to the corporation in  
25 the State of domicile under a consistent -- internal

1 consistency analysis.

2 Now, as I said, the proportionality approach is  
3 one way of dealing with the problem, but again it doesn't  
4 solve the problem of a corporation obtaining a tax benefit  
5 completely, because to the extent that less than --

6 QUESTION: Wait, only if Illinois or, you know,  
7 some other State decides to give it the tax benefit, and  
8 that's none of your business. If some other State wants  
9 to give them a tax double benefit, that's none of  
10 California's business.

11 MR. LEW: Sure. I agree.

12 QUESTION: So -- but that's the tax benefits  
13 you're talking about.

14 MR. LEW: No. I'm talking about the tax benefit  
15 that arises when a corporation incurs debt, is able to  
16 write off the interest expense from that debt, and at the  
17 same time use that debt, either directly or indirectly, to  
18 generate income which California is not permitted to tax.  
19 That is the double tax benefit that I'm talking about.

20 QUESTION: Yes, but California asserts here the  
21 right to treat it as though it was all used, the money, to  
22 generate nonbusiness income.

23 MR. LEW: That's right. That is correct.

24 QUESTION: Even though we know on the facts of  
25 this case, don't we, that that isn't true, and there's no

1 move made by California to do any allocation.

2 MR. LEW: Well, I don't agree that under the  
3 facts of this case that was -- that is, in fact, the case.  
4 If the Court is -- if Your Honor is referring to the  
5 stipulation, then I don't believe that that is what the  
6 parties stipulated. If the parties stipulated --

7 QUESTION: Where are you reading from, Mr. Lew?

8 MR. LEW: I'm reading from joint appendix page  
9 21, stipulation number 14. I believe that is what Justice  
10 O'Connor was --

11 QUESTION: Well, that doesn't cover that point,  
12 but -- and I can find it elsewhere, I assume, but let me  
13 ask you this. Let's assume what I said is true. The  
14 effect of the California provision would be to not  
15 allocate it at all.

16 MR. LEW: It -- well --

17 QUESTION: You treat it as though all of the  
18 expense incurred in borrowing money went to the outside  
19 nonunitary business.

20 MR. LEW: Well, what -- again, and I know that  
21 I've said this before, what California is attempting to do  
22 is basically ensure that none of the interest expense was  
23 used, in fact, to generate income which California's not  
24 permitted to tax.

25 QUESTION: Is it your position, Mr. Lew, that

1 California in the long run, by its system, doesn't -- is  
2 not able to tax any more income than it would be by the  
3 proportionality just because some people get a break and  
4 others don't under it?

5 MR. LEW: I'm not sure if I understand your  
6 question completely, Your Honor, but let me try to answer  
7 it this way. I think that the argument -- the criticisms  
8 that can be leveled against California's statute can also  
9 be leveled against a proportionality approach in the sense  
10 that a certain portion of interest expense is being  
11 allocated to nonbusiness, nontaxable income.

12 Now, we don't know whether or not the amount  
13 that was allocated is the correct amount, but it does have  
14 the effect of increasing the corporation's tax in the  
15 State of California, so to the extent that that can be  
16 viewed as an indirect taxation of nontaxable income, that  
17 is what is being done there, and that's the same criticism  
18 that's being made in our case as well.

19 QUESTION: You can't ask the State to do more  
20 than it can do. I mean, if it's hard to do it, hard to  
21 allocate it, that's an effort, that's a reasonable effort,  
22 so they're not unreasonable when they make a reasonable  
23 effort, even if it doesn't all work out perfectly.

24 But given the possibility of that reasonable  
25 effort, what justification is there for taking the money

1       that's not apportionable?

2                   MR. LEW: Well, again -- same argument, Your  
3       Honor, and that I think is -- it's a reasonable objective,  
4       and the approach that it takes is the surest way of  
5       closing that loophole.

6                   QUESTION: Well, it's sure all right. It's 100  
7       percent dollar-for-dollar. I mean, it makes no effort to  
8       apportion, and you're going to have to persuade me that  
9       that's reasonable, because I don't find anything in what  
10      you've said that makes me think that's reasonable. No  
11      other State does that. There's no effort made to allocate  
12      it. I just -- I have yet to hear a reason.

13                  QUESTION: I guess --

14                  QUESTION: Except I want to be sure, 100 percent  
15      sure.

16                  QUESTION: I guess the California supreme court  
17      case on which the California court of appeal decision here  
18      was based was decided a long time ago.

19                  MR. LEW: That's correct.

20                  QUESTION: Before our decisions in Allied-Signal  
21      and ASARCO.

22                  MR. LEW: That's correct.

23                  QUESTION: Right. And it's sort of hard for you  
24      to give up that old 1972 California supreme court opinion.

25                  (Laughter.)

1                   MR. LEW: Well, I think that -- I think that in  
2                   that the court, the California supreme court has held that  
3                   it does not result -- that the allocation of interest  
4                   expense to nontaxable income on a dollar-for-dollar basis  
5                   does not constitute a tax, I think it's still applicable  
6                   here, even in light of Allied-Signal and other cases.

7                   QUESTION: The argument has been made that if  
8                   you look at how the Federal taxation works, income  
9                   taxation, in the main there is an allocation, but there's  
10                  also an argument that at least in one respect the Federal  
11                  income tax -- I forgot whether it's -- it has something to  
12                  do with foreign investment, or foreign corporations, that  
13                  the Internal Revenue Code does what California does in  
14                  that one discrete area.

15                  MR. LEW: That is my understanding, yes, Your  
16                  Honor, that there is a dollar-for-dollar allocation  
17                  allowed under certain circumstances in the Federal scheme.

18                  QUESTION: So you could make the argument that  
19                  if it's rational for the Internal Revenue Code to do that,  
20                  so it's rational for California to --

21                  MR. LEW: I think there's a basis for doing  
22                  that, Your Honor. I also believe that in -- that section  
23                  265 of the Internal Revenue Code as well provides for a  
24                  dollar-for-dollar offset in certain situations.

25                  QUESTION: If I'm right -- I don't know if this

1 is the only place that does that in the code. There's a  
2 rule which my law clerk found which is a controlled  
3 foreign corporation netting rule, and that has to do with  
4 a circumstance where you have to allocate income expense  
5 to certain foreign source income earned when you lend the  
6 money to a controlled foreign corporation and there's both  
7 been an increase in lending and an increase in borrowing.

8                 And under those circumstances there is some  
9 rationality, where you've loaned more money to your off-  
10 shore corporation, and at the same time you've increased  
11 the borrowing, so I could at least see a rational there  
12 for saying we're going to assume this extra lending is  
13 allocated to the extra borrowing, but I don't think you  
14 even have anything like that here.

15                 MR. LEW: Well, I --

16                 QUESTION: In other words, it's a tracing rule,  
17 rather than an allocation rule. All that your opponent is  
18 asking is that you either allocate or trace, but you've  
19 done neither.

20                 MR. LEW: Well --

21                 QUESTION: The Federal provision seems to try to  
22 trace.

23                 MR. LEW: Right. The California statute is  
24 definitely not a tracing rule. It's actually just an  
25 assignment rule, and it's basically based on the idea that

1 it's extremely difficult, if not impossible, to trace  
2 interest expense to its ultimate use or application, and  
3 again it's just based on the idea that this is what --  
4 California's interest in trying to close this loophole.

5 That's what the statute is trying to do, and I  
6 think that to the extent that that constitutes a  
7 legitimate State objective, I think it certainly  
8 accomplishes that goal, and it does so, I think, in a fair  
9 way in the sense that it does allow that first step to  
10 allocate interest expense to -- on the basis of business  
11 interest income, and to the extent that there is any  
12 remaining, it does allocate it against its nonbusiness  
13 income.

14 QUESTION: Why can't you just ask the taxpayer  
15 to assume the burden of persuading you that any  
16 interest -- any income, or interest deduction that it  
17 seeks to obtain is attributable to the unitary business?

18 MR. LEW: Well, I think that that is -- that is  
19 one way to go, but I think that's also subject to  
20 manipulation as well, Your Honor.

21 QUESTION: The same is true of payroll and other  
22 expenses in this gigantic balance sheet and income  
23 statement they have to prepare in these things. There's  
24 always room for --

25 MR. LEW: And that's -- I think the problem, if

1 you're trying to determine, you know, a corporation's  
2 motive, I think that's just, as a matter of tax  
3 administration, extremely difficult to do, and it's  
4 essentially a facts and circumstances kind of test, and I  
5 just think that it's extremely difficult to administer  
6 that kind of test, you know, especially for a State like  
7 California.

8 That, I think, is what the problem is, and that  
9 is why there is this statute, which essentially eliminates  
10 any type of concept of motive or, you know, purpose, and  
11 just says, look, if you have interest expense, and you are  
12 using some of your capital to generate income that is not  
13 taxable in the State of California, that there is the --

14 QUESTION: It does seem to me it's not entirely  
15 unlike taking the president of the corporation's salary.  
16 You do some allocating there. You've got to -- you know,  
17 there's room for -- I don't know why interest is any  
18 harder to allocate than something like that.

19 MR. LEW: Oh, it's -- well, interest is harder  
20 to allocate than other -- the thing about interest is that  
21 it is extremely fungible, I guess is the best way to put  
22 it, and you can't --

23 QUESTION: The dollars paid to the president of  
24 the corporation is pretty fungible, too.

25 QUESTION: Is there any --

1                   QUESTION: For salary, I mean.

2                   QUESTION: Is there any requirement that the  
3                   interest deduction be based on loans that were made in  
4                   California, or can they be made anywhere?

5                   MR. LEW: I believe they can be made anywhere,  
6                   Your Honor.

7                   QUESTION: Do you think that California, if we  
8                   were not to accept your position, and were to say that you  
9                   have to make some effort to allocate, California could do  
10                  that --

11                  MR. LEW: Yes. I think it --

12                  QUESTION: -- without having a new statute that  
13                  does it? That is, the example -- which company was it  
14                  that we have in these cases? Is it General Motors, or  
15                  General Electric? I don't remember. Could the tax  
16                  commissioner say, well, what we did is no good, here's  
17                  something else that is good, so we're going to do that  
18                  even though we don't have a statute that so provides?

19                  MR. LEW: Yes. It is my belief that that could  
20                  probably be done pursuant to other California regulatory  
21                  authority which allows for a spreading of interest expense  
22                  similar to the method that has been endorsed by the  
23                  petitioner. I don't think that it would necessarily  
24                  require a -- the enactment of a new statute.

25                  I don't really have anything else. If the Court

1 has any further questions I'll be happy to answer them.  
2 Other than that, I'm done.

3                   QUESTION: Thank you, Mr. Lew.

4                   Mr. Hellerstein, you have 5 minutes remaining.

5                   REBUTTAL ARGUMENT OF WALTER HELLERSTEIN

6                   ON BEHALF OF THE PETITIONER

7                   MR. HELLERSTEIN: I have three very brief  
8 points. First, with regard to the CFC netting rule that  
9 both Justice Breyer and Justice Ginsburg referred to,  
10 you're quite right, Justice Breyer, the CFC netting rule  
11 is, in fact, a very finely tuned tracing rule, as Justice  
12 Scalia said. It only arises in a situation when  
13 there's -- you go to some unrelated lender, you borrow  
14 money, you then relend that money to your controlled  
15 foreign corporation, the controlled foreign corporation  
16 then pays you interest.

17                  That's the situation we're talking about. If  
18 California had anything like that, we certainly wouldn't  
19 be here. Again, a finely tuned mechanism addressed to a  
20 specific tax evasion problem which actually doesn't  
21 even -- it just reduces the foreign tax credit, is what  
22 we're talking about. It's not even a -- it's not a  
23 jurisdictional problem.

24                  Point two, Mr. Lew suggested, gee, these -- all  
25 these other formulas that we're suggesting are reasonable

1       are vulnerable to the same sort of criticism that we're  
2       making, and that's not true. The criticism that we're  
3       making is that the California formula disproportionately  
4       assigns interest expense to nontaxable income. All of  
5       those other formulas do it on an even-handed,  
6       nondiscriminatory basis.

7                 And finally, his suggestion that, because the  
8       statute is internally consistent it is therefore  
9       constitutional, is a non sequitur. It would be -- if  
10      California had a statute that assigned income based on the  
11      number of square miles in a State, that would be  
12      internally consistent, but I think would plainly be  
13      unconstitutional and, indeed, in cases involving  
14      retaliatory taxes, which are entirely consistent, this  
15      Court has also held they are unconstitutional.

16                 If the Court has no further questions --

17                 CHIEF JUSTICE REHNQUIST: Thank you, Mr.  
18       Hellerstein. The case is submitted.

19                 (Whereupon, at 12:16 p.m., the case in the  
20       above-entitled matter was submitted.)

21  
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## CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

HUNT-WESSON, INC. Petitioner v. FRANCHISE TAX BOARD OF CALIFORNIA  
CASE NO: 98-2043

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Jean Marie Frederic -----  
(REPORTER)