



This Week in State Tax (TWIST)

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California: Appeals Court Rejects Suit Seeking to Invalidate Single-Sales Factor Apportionment

In 2017, a Texas-based company called One Technologies filed a complaint alleging that The Clean Energy Jobs Act or Proposition 39, which was approved by California voters in November 2012, should be invalidated as violating the state constitutional single-subject rule for initiative measures. Proposition 39 mandated that most corporate taxpayers use single-sales factor apportionment and the corresponding market-based sourcing rules. It also created a special apportionment rule for cable companies and created a fund for clean energy projects. Prior to Proposition 39, taxpayers could elect between a single sales factor formula with market-based sourcing, or a three factor double-weighted sales formula with costs of performance sourcing. The complaint alleged that the three components of Proposition 39 were not unified under a common subject, object, or purpose, which rendered it invalid under the California Constitution. Specifically, the taxpayer asserted that the special tax break for cable companies had no reasonable connection to the Proposition's overall purpose of funding the creation of clean energy jobs. If instead the purpose of the proposition was to modify the tax scheme for multistate businesses, the taxpayer claimed the Job Creation Fund was unrelated to that purpose. The taxpayer requested a refund of corporate income tax on the basis that it should have been permitted to file using three-factor double weighted apportionment and costs of performance sourcing. After a Los Angeles County Superior Court judge dismissed the complaint on the basis that the company failed to state a valid cause of action, the taxpayer appealed.

The single-subject rule arises under the California Constitution, which provides, "an initiative measure embracing more than one subject may not be submitted to the electors or have any effect." The rule was, in part, adopted to minimize the risk of voter confusion and deception. On appeal, the court held that Proposition 39 did not violate the single-subject rule. The purpose of Proposition 39 was to fund a clean energy job creation program by raising taxes on some multistate businesses and the provisions of the proposition were both reasonably germane and functionally related to that purpose. Notably, the provisions established a funding mechanism and the means of directing that funding to clean energy job creation. In the court's view, the special rule for cable companies reflected a determination by the drafters that some businesses should bear the funding burden more than others. The court further rejected the taxpayer's contentions that Proposition constituted "logrolling" because it combined a likely unpopular change (cable company tax break) with a popular change (job creation). Relying on an earlier California case, the court determined that "logrolling" was not a separate basis (apart from the single-subject rule) to invalidate an initiative. Please contact Oksana Jaffe with questions on *One Technologies, LLC v. Franchise Tax Board*.

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