No. 18-0566

IN THE SUPREME COURT OF TEXAS

LOCKHEED MARTIN CORPORATION,
Petitioner

v.

GLENN HEGAR, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, AND KEN PAXTON, ATTORNEY GENERAL OF THE STATE OF TEXAS,
Respondents.

On Petition for Review
from the Third Court of Appeals, Austin
Cause No. 03-16-00303-CV

BRIEF OF COUNCIL ON STATE TAXATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. Its membership is comprised of approximately 550 of the largest multistate corporations engaged in interstate and international business and represents industries doing business in every state across the country.[1] Its objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities, many of which do business in Texas. In furtherance of its objective, COST previously has participated as amicus in numerous significant federal and state tax cases since its formation in 1969.

Here, COST's comments provide its unique perspective as a trade association with members engaged in business in all 50 states across a wide range of industries and required to comply with tax apportionment rules in multiple jurisdictions. COST has a keen interest in this case because fair tax administration depends upon equitable and judicious administration of state tax laws. This Court should accept review of the Appeals Court decision to ensure the Texas Franchise Tax is administered equitably in instances where a business makes a sale to a foreign buyer that would otherwise be sourced outside of Texas but for the fact that the taxpayer is subject to a federal mandate that requires the Department of

[1] No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation of submission of this brief. No person other than *Amicus Curiae*, their members, or their counsel made a monetary contribution to its preparation or submission. Tex. R. App. P. 11.

Defense (DoD) to act as a purchasing intermediary to protect important national security interests. Under these circumstances, Texas should not disadvantage a Texas manufacturer, as compared to other similarly situated sellers, simply because a federal law dictates a seller of sensitive military equipment must utilize the DoD as an intermediary to facilitate and monitor sales transactions with foreign-government buyers.

ARGUMENT

I. Lockheed Martin's Military Sales To Foreign-Government Buyers Are Not Texas-Sourced Sales Under The Texas Franchise Tax.

A. The Foreign Military Sales Process Protects National Security Interests And Does Not Convert Sales To Foreign-Government Buyers Into Texas-Sourced Sales.

The Texas Franchise Tax sourcing rule is intended to equitably attribute a portion of a taxpayer's sales to Texas by apportioning the taxpayer's sales using a fraction that includes in the numerator sales made to Texas buyers and in the denominator all of the taxpayer's sales. Specifically, Texas law provides that this apportionment ratio under the Texas Franchise Tax is Texas receipts—"gross receipts from business done in this state"—divided by total receipts—"gross receipts from [taxpayer's] entire business." Tex. Tax Code §171.106(a); §171.106(b) (2003) ("Former §171.106(b)").

There is no factual dispute in this case. Lockheed Martin ("LM") manufactured fighter jets (F-16s) at a facility in Fort Worth, Texas and sold F-16s

to specifically identified foreign-government buyers from Chile, Greece, Israel, Oman, and Poland. There is also no disagreement that the F-16s were delivered to the foreign governments in their respective countries outside the United States. The only dispute is whether a federal law mandating (for purposes of national security) the U.S. Government serve as an intermediary to facilitate sales between LM and foreign-government buyers somehow changes the sourcing of the sale from a non-Texas sale into a Texas-sourced transaction.

The relevant federal law, the Arms Export Control Act (the Act), regulates and restricts sales of U.S.-manufactured military goods to foreign nations. Arms Export Control Act of 1976, Pub.L. 94–329, 90 Stat. 729, codified at 22 U.S.C. §§ 2751 *et seq*. For obvious national security and foreign policy reasons, the Act prohibits certain types of highly sensitive military weapon products and systems (such as the F-16 fighter jets, air-to-air missiles, and ballistic missile defense items) from being sold directly to a foreign- government buyer by a U.S. manufacturer in a commercial transaction. Instead, sales of these products and weapons systems must comply with the mandated Foreign Military Sales (FMS) process. See 22 U.S.C. §§ 2761-62.

The FMS process inserts the U.S. government as an intermediary in the purchase-and-sale transaction between LM (and other sellers) and foreign-government buyers. The FMS program is administered by the DoD. Under the Act,

LM can only sell military products covered by the Act if the DoD acts as an intermediary to facilitate the sales to foreign buyers. To protect national security interests, the DoD enters into combined contracts with both the seller and the ultimate foreign-government buyer. Under the terms of the combined contracts between LM and the DoD and the DoD and foreign-government buyers, the DoD acts as an intermediary to:

- Approve the sale (of the F-16s) to the foreign-government buyer,
- Convey to the seller certain specifications dictated by the foreign buyer,
- Facilitate the integration of components provided by the foreign buyer for use by the seller in the final product,
- Collect payment from the foreign buyer,
- Provide final payment for the sales transaction to LM (the seller),
- Take delivery of the planes at the seller's facility in Texas, and
- Almost immediately upon the transfer of the planes, transport the planes using military pilots (for national security purposes) to the foreign location of the buyer.

All these steps must be followed to comply with the statutory requirements of the Act.

As a result, what would normally be a straightforward sale by a Texas manufacturer to a known foreign-government buyer with delivery outside the United States, thus not sourced to Texas for Franchise Tax apportionment purposes, is complicated by additional steps mandated by the United States government for national security purposes. Nonetheless, the substance and result of the transaction is the same as a direct sale. The FMS process is rooted in a national security system necessary to closely regulate and monitor the sale of highly sensitive military equipment to foreign-government buyers. The U.S. government cannot adequately maintain control over this country's national defense and foreign policy priorities if it fails to exercise strict oversight and control of U.S. companies' sales of major defense weapon systems to foreign governments.

The Act's goal, to protect national security interests, was not intended to contravene clear state tax principles that define sourcing rules related to sales to foreign buyers for purposes of the Franchise Tax. LM has no choice but to abide by federal laws that mandate how sales of sensitive military equipment to foreign-government buyers transpire. But for the federal law, LM could easily arrange for the sale to occur directly with the foreign-government buyer, removing any question of how it would be sourced for Texas Franchise Tax purposes. This, however, clearly would not be in the Unites States' national defense security interests. The mere fact that LM is manufacturing and selling a product of critical

importance to national security interests should not deprive it of the ability to source its sales as would any other Texas manufacturer making a sale to a foreign buyer with delivery outside the United States.

Given the import of this decision to the equitable treatment of large defense contractors that operate manufacturing facilities and employ thousands of workers in Texas, this Court should accept review of this case to weigh in on this significant fact pattern. This case also represents a symbolic and important business climate issue for Texas to retain and attract business. LM has made significant investments in its production facilities in Fort Worth, Texas, and it has hired hundreds of employees to manufacture planes for sales to foreign governments at this facility. LM should be able to rely on Texas Franchise Tax sourcing rules that source sales of products delivered to locations outside of Texas as non-Texas-sourced sales.

In this case, there is no disagreement that LM's actual buyers are foreign governments. The mere fact that the federal Act requires the seller and buyer to utilize the DoD as an intermediary in order to protect important national security interests should not alter the substance of the transaction and change the result from the perspective of state tax apportionment rules.

B. The Court of Appeals Misconstrued the Transaction Between LM and the Federal Government as a Sale for Resale.

The Court of Appeals "acknowledged . . . the U.S. government to some extent does act "on behalf of" a foreign government or akin to a hired purchaser when conducting FMS procurements." *Lockheed Martin Corp. v. Hegar*, 550 S.W.3d 855, 869 (Tex. Ct. App. 2018). However, the Court of Appeals erroneously treated this transaction as two separate sales: first as a sale for resale to the U.S. government, and second as a sale by the U.S. government to the foreign-government buyers.

There are a number of problems with this analysis. First, the transaction between LM and the federal government has none of the traditional indicia of a "sale for resale." Unlike a typical sale for resale, the DoD intermediary has no ability to independently choose its own buyer since the identity of the foreign-government buyer is known before the intermediary receives the property from the seller. The price of the sale is likewise fixed, and the intermediary is not permitted to profit from the transaction nor is it subject to any financial risk on the transaction. Moreover, the buyer has the right to specify or provide certain components that LM then integrates into the final product.

The lower court failed to differentiate two different types of FMS sales that involve DoD oversight and participation. One part of the FMS program involves the DoD selling military equipment directly from its own existing inventory—more akin to a sale for resale transaction. 22 U.S.C. §2761. Under this program, the DoD

purchases military equipment from manufacturers for its own supply purposes, and the DoD later sells those goods to foreign buyers out of its own stock of equipment.

LM's sales of F-16s to foreign-government buyers, however, are conducted using a very different FMS process—one that restricts the role and autonomy of the DoD in the sales transaction. Under this process, the federal government, both in form and substance, acts as an intermediary facilitating the transaction to address national security concerns. The federal government, however, does not directly sell this military equipment out of its own inventory and in no way shapes the contents or price paid by the foreign buyer of the military equipment. In this fact pattern, the sale was properly sourced as a non-Texas sale because the ultimate delivery of the military equipment to a foreign buyer outside of Texas is not a Texas-sourced sale. Thus, if the Court of Appeals decision is allowed to stand, it would lead to a bifurcated approach to sourcing non-Texas foreign sales for purposes of the Texas Franchise Tax, unfairly treating in-state manufacturers' sales of sensitive military equipment and systems as Texas-sourced sales, when other products not required to use the DoD as an intermediary would not be construed as a Texas-sourced sale.

CONCLUSION

Lockheed Martin has additional arguments warranting this Court's review, and full briefing will allow this Court to consider all those issues, which affect a wide range of Texas sellers. COST has focused this brief on one of the issues,

which by itself reveals the need for this Court's review of the judgment below. This Court's review of this case will clarify for purposes of the Texas Franchise Tax that Texas-manufactured fighter jets sold and delivered outside of Texas to foreign-government buyers subject to strict federal government regulation and oversight are not Texas-sourced sales. For the foregoing reasons, COST urges this Court to accept review of this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing brief was served on all counsel of record through the Court's electronic filing system on April 26, 2019.

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CERTIFICATION OF COMPLIANCE

I certify that the foregoing brief was prepared using Microsoft Word 2016, and that, according to its word-count function, the sections of the foregoing brief covered by TRAP 9.4(i)(1) contain 1,926 words in a 14-point font size and footnotes in a 12-point font size.

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