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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

ABERCROMBIE & FITCH CO. et al.,

Plaintiffs and Appellants,

v.

CALIFORNIA FRANCHISE TAX BOARD,

Defendant and Respondent.

F074873

(Super. Ct. No. 12CECG03408)

OPINION

APPEAL from a judgment of the Superior Court of Fresno County. Alan M. Simpson, Judge.

Silverstein & Pomerantz, Amy L. Silverstein and Robert T. Petraglia, for Plaintiff and Appellant.

Xavier Becerra, Attorney General, Edward C. Dumont, Solicitor General, Diane S. Shaw, Assistant Attorney General, Stephen Lew and Tim Nader, Deputy Attorneys General, Aimee Feinberg, Deputy Solicitor General, for Respondent.

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Plaintiff Abercrombie & Fitch Co. and its subsidiaries (Abercrombie) sued California's Franchise Tax Board (Board) for a tax refund. Abercrombie argued California's statutory scheme unconstitutionally discriminated against interstate commerce by providing a benefit to in-state businesses that was not available to out-of-state businesses. Specifically, the statutes allow intrastate unitary businesses to choose whether to compute their tax using the combined reporting method or the separate accounting method. (Rev. & Tax. Code, § 25101.15.)[1] Interstate unitary businesses, in contrast, are required to compute their tax under the combined reporting method. (§ 25101.)

During a bench trial, the court granted the Board's motion for judgment under Code of Civil Procedure section 631.8 on two separate grounds. First, the court determined Abercrombie failed to prove the statutes were discriminatory. Second, the court determined Abercrombie failed to prove the alleged discrimination caused the damages claimed. Specifically, the court determined allowing Abercrombie to use separate reporting in a nondiscriminatory way would not have reduced its tax liability for the year in question and, therefore, no refund was owed.

We assume Abercrombie established the elements of its facial challenge to the constitutionality of the statutes by showing (1) the statutes provided for differential treatment of intrastate unitary businesses and interstate unitary businesses and (2) this difference in treatment provided a benefit to intrastate unitary businesses and burdened interstate unitary businesses by depriving them of the benefit, which resulted in discrimination against interstate commerce. We also assume the state failed to carry its burden of showing the discriminatory measures advanced a legitimate local purpose that could not be adequately served by reasonable nondiscriminatory alternatives.

[1] Unlabeled statutory references are to the Revenue and Taxation Code.

These assumptions lead to the questions of causation and damages decided by the trial court. The trial court was not convinced that Abercrombie's tax liability would have been less had Abercrombie applied the separate reporting method in a way that did not give it an advantage over intrastate unitary businesses. On appeal, Abercrombie has not demonstrated the trial court was compelled to make findings in its favor on the amount of its tax liability under a nondiscriminatory reporting scheme. Abercrombie's evidence on the question of damages was not uncontradicted and unimpeached and of such a character and weight as to leave no room for a judicial determination that it was insufficient to support a finding. Therefore, we conclude the trial court did not err when it determined Abercrombie failed to carry its burden of proof as to damages.

We therefore affirm the judgment.

FACTS AND PROCEEDINGS

Abercrombie & Fitch Co. is a Delaware corporation. The corporation and its 14 subsidiaries (collectively, Abercrombie) are the plaintiffs and appellants in this litigation. Abercrombie engages in a multistate unitary business that consists primarily of selling clothing at retail. As an interstate unitary business, it was required by Revenue and Taxation Code section 25101 to determine the portion of its total income subject to tax in California under a combined reporting method, which treats all the entities of the corporate family as a single business and applies a formula to that business's income to determine the amount attributable to, and taxable by, California. Unitary businesses and the two reporting methods at issue in this case—separate and combined—are described in further detail in part I.C., *post*.

Abercrombie filed a tax return with the Board for its fiscal year ended January 29, 2000. After an audit, the Board proposed assessing additional taxes for that year. Eventually, Abercrombie paid the assessment plus interest and filed an administrative claim for a tax refund. In pursuing a refund, Abercrombie completed the required administrative steps, including filing appeals with the State Board of Equalization. In this appeal, the Board does not dispute Abercrombie's claim it exhausted the available administrative remedies.

Tax Refund Lawsuit

In October 2012, Abercrombie filed a verified complaint against the Board for refund of taxes. The complaint alleged the California statutes unconstitutionally discriminated against interstate commerce by allowing only intrastate unitary businesses to file tax returns on either a combined or separate reporting basis while requiring interstate unitary businesses to use combined reporting. In the prayer for relief, the complaint sought a refund of approximately $181,591 of corporation franchise taxes paid for the fiscal year ended January 29, 2000, plus interest, attorney fees and costs. The prayer for relief did not request the portion of section 25101.15 that gives intrastate unitary businesses a choice of reporting methods to be struck down as unconstitutional.

Motions for Summary Adjudication

In April 2014, the parties filed cross-motions for summary adjudication in asking the trial court to decide the following issue:

> "Whether California unconstitutionally discriminates against interstate commerce by allowing a corporation engaged in a unitary business wholly within California to choose annually whether to determine its income and tax using either combined reporting or separate reporting while corporations engaged in a unitary business within and without California are required to use combined reporting?"

After briefing on the cross-motions was completed, the trial court stayed the proceeding until the Fourth District decided *Harley-Davidson, Inc. v. Franchise Tax Bd.* (2015) 237 Cal.App.4th 193 (*Harley I*). After *Harley I* was filed, the trial court requested supplemental briefing to address its impact. The Board argued *Harley I* did not dispose of the issues raised in the pending cross-motions for summary adjudication because *Harley I* addressed only the sufficiency of the pleadings and remanded for further proceedings. In contrast, Abercrombie argued *Harley I* and the undisputed facts of the present case required its motion for summary adjudication to be granted.

The trial court issued a tentative ruling to deny both motions. After a hearing, the court issued a minute order adopting its tentative ruling. The ruling stated Abercrombie's expert had identified four ways in which an interstate unitary business might bear a higher tax burden, but no evidence was presented showing any of the four possibilities actually caused Abercrombie's tax liability to be higher. The ruling also stated the record was not sufficiently developed for an application of the strict scrutiny standard—that is, to determine whether a legitimate state purpose justified allowing only intrastate unitary businesses a choice of reporting methods.

Trial and Judgment

In September 2016, a four-day bench trial was held. Abercrombie presented two witnesses—Kevin Reddick and Brian Pedersen. Reddick had worked for Abercrombie since 1999 in various positions. He was Abercrombie's director of state and local income, franchise and property tax when he testified. Reddick prepared Abercrombie's California tax return for the fiscal year in question and testified about the additional time and expense of preparing a combined tax return. Pedersen, a managing director of Alvarez & Marsal Taxand, LLC, was qualified as an expert in state corporate income tax. Pedersen testified about the apportioning of income of interstate and intrastate unitary businesses and the impact of using separate or combined reporting.

After Abercrombie rested, the Board moved for judgment under Code of Civil Procedure section 631.8, which the trial court granted. The court directed counsel for the Board to prepare a proposed statement of decision for review and finalization by the court.

On October 31, 2016, the trial court signed and filed a statement of decision. The same day, it entered judgment in favor of the Board. Abercrombie filed a notice of appeal challenging the judgment and the December 2015 denial of its motion for summary adjudication.

DISCUSSION

I. *Basic Legal Principles*

A. Motions for Judgment

1. Trial Court's Authority

The procedural context for this appeal is established by Code of Civil Procedure section 631.8, subdivision (a), which authorizes a party in a nonjury trial to move for a judgment after the opposing party has completed its presentation of evidence. Here, the Board moved for judgment after Abercrombie had completed presenting the evidence in its case-in-chief. When a motion for judgment has been made, "[t]he court as trier of the facts shall weigh the evidence and may render a judgment in favor of the moving party" or, alternatively, "may decline to render any judgment until the close of all the evidence." (Code Civ. Proc., § 631.8, subd. (a).) If a judgment is rendered, the court is required to issue a statement of decision. (*Ibid*.) A motion for judgment is not the equivalent of a motion for nonsuit because it is not limited to challenging the legal sufficiency of the opposing party's evidence.

2. Standards of Appellate Review

Abercrombie contends its appeal challenges conclusions of law based on undisputed facts and, therefore, we "are free to draw our own conclusions of law." (*Torrey Pines Bank v. Hoffman* (1991) 231 Cal.App.3d 308, 317.) When a trial court issues a judgment pursuant to Code of Civil Procedure section 631.8, the standards of appellate review are the same as if the court had rendered a judgment after a completed bench trial. (*Orange County Water Dist. v. MAG Aerospace Industries, Inc.* (2017) 12 Cal.App.5th 229, 239.) The trial court's findings of fact are reviewed under the substantial evidence standard and its determinations of questions of law are subject to independent review. (*Id*. at p. 240.)

Here, the trial court resolved essential elements of Abercrombie's claim for a refund—specifically causation and damages—by determining Abercrombie failed to carry its burden of proof. Where the trier of fact has determined the party with the burden of proof did not carry that burden, "it is misleading to characterize the failure-of-proof issue as whether substantial evidence supports the judgment.… [¶] [W]here the issue on appeal turns on a failure of proof at trial, the question for a reviewing court becomes whether the evidence compels a finding in favor of the appellant as a matter of law. [Citations.] Specifically, the question becomes whether the appellant's evidence was (1) 'uncontradicted and unimpeached' and (2) 'of such a character and weight as to leave no room for a judicial determination that it was insufficient to support a finding.'" (*In re I.W.* (2009) 180 Cal.App.4th 1517, 1528; see *Dreyer's Grand Ice Cream, Inc. v. County of Kern* (2013) 218 Cal.App.4th 828, 838 (*Dreyer's*); *Valero v. Board of Retirement of Tulare County Employees' Assn.* (2012) 205 Cal.App.4th 960, 965.) Based on the foregoing precedent, we conclude the finding-compelled-as-a-matter-of-law standard applies to the trial court's determinations that Abercrombie failed to prove its tax liability would have been reduced by a nondiscriminatory use of separate reporting.

B. Dormant Commerce Clause

1. Overview

The commerce clause of the federal Constitution delegates to Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." (U.S. Const., art. I, § 8, cl. 3.) This explicit grant of power has been interpreted as an *implied* limitation on the power of states to adopt statutes and regulations that burden or interfere with interstate commerce. (*West Lynn Creamery, Inc. v. Healy* (1994) 512 U.S. 186, 192.) This implied limitation is known as the

" 'dormant' " or " 'negative' " commerce clause. (*Barclays Bank Plc v. Franchise Tax Bd. of Cal.* (1994) 512 U.S. 298, 310, fn. 9.) The dormant or negative aspect of the commerce clause prohibits economic protectionism—that is, enactments designed to benefit in-state economic interests by burdening out-of-state competitors. (*Fulton Corp. v. Faulkner* (1996) 516 U.S. 325, 330.) In the field of taxation, the dormant commerce clause prevents a state from imposing "a tax [that] discriminates against interstate commerce … by providing a direct commercial advantage to local business." (*Northwestern States Portland Cement Co. v. Minnesota* (1959) 358 U.S. 450, 458.)

Decisions of the United States Supreme Court have been described as recognizing three basic types of discrimination against interstate commerce. "First, a State regulation can be facially discriminatory. Second, a facially neutral regulation may be discriminatory in purpose. Finally, as a third form, a State regulatory scheme may be discriminatory in effect." (Day, *The Expanded Concept of Facial Discrimination in the Dormant Commerce Clause Doctrine* (2007) 40 Creighton L.Rev. 497, 502, footnotes omitted (*Commerce Clause Doctrine*).) Some argue that the role of purpose (also described as intent or motive) is gaining importance in dormant commerce clause analysis at the expense of discriminatory effect. (See Francis, *The Decline of the Dormant Commerce Clause* (2017) 97 Denv. L.Rev. 255, 286-288.) For instance, Chief Justice Roberts referred to motive, not effect, in stating: "Discriminatory laws motivated by 'simple economic protectionism' are subject to a 'virtually *per se* rule of invalidity,' [citation], which can only be overcome by a showing that the State has no other means to advance a legitimate local purpose [citation]." (*United Haulers Assn., Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.* (2007) 550 U.S. 330, 338-330 (*United Haulers*).)

2. *Legal Standards for Constitutionality*

In *Harley-Davidson, Inc. v. Franchise Tax Bd.* (2018) 27 Cal.App.5th 245 (*Harley II*), the Fourth District stated the first question in analyzing whether a state's taxation scheme violates the dormant commerce clause is whether the taxation scheme *discriminates* against interstate commerce. (*Id*. at p. 254.) This view of the law is consistent with decisions of the United States Supreme Court. (See *United Haulers*, *supra*, 550 U.S. at p. 338 ["we first ask whether it discriminates on its face against interstate commerce"].)

The test for discrimination has two elements. The first element is differential treatment of in-state and out-of-state economic interests. (*Harley II*, *supra*, 27 Cal.App.5th at p. 254.) The second element addresses the consequences of that difference—specifically, whether in-state businesses are benefited and out-of-state businesses are burdened. (*Ibid*.)

When both elements of the discrimination test are established, the statutory scheme is invalid unless the justifications for the discriminatory burden on commerce pass a strict scrutiny test. (*Harley II*, *supra*, 27 Cal.App.5th at p. 254.)[2] Under that standard, "a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." (*New Energy Co. of Indiana v. Limbach* (1988) 486 U.S. 269, 278 (*New Energy*); see *Harley II*, *supra*, 27 Cal.App.5th at p. 254; Francis, *The Decline of the Dormant Commerce Clause*, *supra*, 97 Denv. L.Rev. at p. 264 [justification of discriminatory regulation].)

C. Overview of Taxation Scheme

All companies doing business within California must pay corporate income tax to the state. Companies doing business only in California calculate their taxable income by

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2 When a regulatory scheme is considered "nondiscriminatory," it is evaluated under a standard more lenient than strict scrutiny. (*Commerce Clause Doctrine*, *supra*, 40 Creighton L.Rev. at p. 499.) This "undue burden" standard, first articulated in *Pike v. Bruce Church, Inc.* (1970) 397 U.S. 137, 142, is not relevant to the issues presented in this appeal. (See Day, *Revisiting Pike: The Origins of the Nondiscrimination Tier of the Dormant Commerce Clause Doctrine* (2004) 27 Hamline L.Rev. 45, 46-47.)

subtracting their losses and expenses from their total income. (§ 23151.) In contrast, when a company's income "is derived from or attributable to sources both within and without [California,] the tax [is] measured by the net income derived from or attributable to sources within this state." (§ 25101.) The determination of the income derived from or attributable to California sources is measured by the proportion of the business's payroll, property, and sales within the state. (See §§ 25120-25137 [apportionment method].) Under this apportionment method, only the California share of the company's income will be taxed by California. (See *Container Corp. of America v. Franchise Tax Bd.* (1983) 463 U.S. 159 [commerce clause challenge to California's apportionment method rejected].)

1. Unitary Businesses

When a business enterprise is formally organized into multiple entities that are functionally integrated, it is known as a "unitary business." Unitary businesses involve " 'two or more business entities that are commonly owned and integrated in a way that transfers value among the affiliated entities.' " (*Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 756, fn. 3; see Cal. Code Regs., tit. 18, § 25120 [criteria used to determine if a business is unitary].)

When a regional, national or international enterprise is organized into multiple entities that do not all operate in the same states, it is difficult to determine the value earned by the entire enterprise from a particular state and, thus, subject to taxation by that state. As described in detail in *Harley II*, the unitary business principle was developed to permit the states to tax a multistate enterprise on an apportionable share of the business carried on within the taxing state. (*Harley II*, *supra*, 27 Cal.App.5th at pp. 251-253.)

2. Two Reporting Methods

The following overview of the reporting methods used in California's taxation scheme is taken from *Harley I*:

> "A unitary business is an enterprise comprised of a number of commonly owned and controlled businesses, each of which is dependent on or contributes to the operation of the entire business enterprise of the group. [Citations.] There are two possible methods for unitary corporate taxpayers to compute their California tax liability: the separate accounting method and the combined reporting method. '[S]eparate accounting treats each corporate entity discretely for the purpose of determining income tax liability.' (*Barclays Bank PLC v. Franchise Tax Bd. of Cal.* (1994) 512 U.S. 298, 305 … (*Barclays*).) The combined reporting method aggregates the entire amount of business income of all corporations in the unitary group. [Citation.]
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> "Taxpayers engaged in a unitary business within and without California—interstate taxpayers—are required to use the combined reporting method. (§ 25101; *Handlery* [*v. Franchise Tax Bd.* (1972)] 26 Cal.App.3d [970,] 973 ['In the case of a "unitary business" the enterprise files a combined report, and the income from its operations within the state is determined by a formula.'].) *Handlery* confirmed that taxpayers engaged in a unitary business wholly within California—intrastate taxpayers—were required to use the separate accounting method. (*Handlery*, at p. 985.) In response to *Handlery*, the Legislature in 1980 enacted section 25101.15, which permits intrastate unitary groups to choose between the combined reporting and separate accounting methods. Thus, as the Board summarizes in its respondent's brief, 'section 25101.15 provide[s] wholly in-state businesses ... an election to file their returns on either a unitary combined reporting basis, or a separate-entity basis. [¶] Multistate unitary businesses have no corresponding election.'" (*Harley I*, *supra*, 237 Cal.App.4th at pp. 199-200, fns. omitted.)

In *Handlery*, *supra*, 26 Cal.App.3d 970 (*Handlery*) the plaintiff corporations argued the Board was constitutionally compelled to treat them as a unitary business and to allow combined reporting. (*Id. at* p. 982.) In its equal protection analysis, the court noted "the complained of classification does fall considerably short of perfection," but concluded there was a reasonable basis for the classifications, which was based upon some difference in the classes having a substantial relationship to a legitimate object to be accomplished. (*Id*. at p. 982.) The court also stated the situation presented was one "where a state classification was designed to avoid constitutional conflict." (*Id*. at p. 983.) The state classification referred to was the "unitary business," a classification then limited to multicorporate businesses conducted both within and without California. (*Id*. at pp. 980-981.) This classification and the combined report interstate businesses were required to use was adopted to fairly allocate to California the business income taxable by California without violating their rights under the due process and interstate commerce clauses. (*Id*. at p. 974.)

In response to *Handlery*, the Legislature considered a bill that would have required intrastate unitary businesses to use combined reporting—the only method available to interstate unitary businesses. (Assem. Bill No. 3754 (1977-1978 Reg. Sess.).) Ultimately, the Legislature enacted section 25101.15, which states in full:

> "If the income of two or more taxpayers is derived solely from sources within this state and their business activities are such that if conducted within and without this state a combined report would be required to determine their business income derived from sources within this state, then such taxpayers shall be allowed to determine their business income in accordance with Section 25101."

When sections 25101 and 25101.15 are read together, in-state businesses are given a choice of reporting methods that is not given to interstate unitary businesses.

II. Discrimination and Strict Scrutiny

For purposes of this appeal, we assume, but do not decide, that Abercrombie has established the two elements of the test for discrimination by showing differential treatment of in-state and out-of-state economic interests that benefited in-state businesses and burdened out-of-state businesses. (See *Harley II*, *supra*, 27 Cal.App.5th at p. 254 [elements].) In other words, we assume California's taxation scheme "discriminates on its face against interstate commerce."[3] (*United Haulers*, *supra*, 550 U.S. at p. 338.)

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[3] Based on this assumption, we need not discuss Abercrombie's argument the trial court erred by treating its constitutional claim as an "as applied" challenge rather than as a facial challenge.

The next step of the commerce clause analysis is to apply the strict scrutiny test. (*Harley II*, *supra*, 27 Cal.App.5th at p. 254.) Under that test, a statute that discriminates against interstate commerce will be upheld if the government demonstrates "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." (*New Energy*, *supra*, 486 U.S. at p. 278; see *Harley II*, *supra*, 27 Cal.App.5th at p. 254.) Here, we also assume the Board did not carry its burden of showing there were no reasonable nondiscriminatory alternatives. These assumptions bring us to the question of the appropriate remedy.

III. Damages and Refund Calculation

A. Abercrombie's Theory of Damages

Abercrombie alleged its corporation franchise tax liability for the year in question was approximately $1,137,526 when it used the combined reporting method. Abercrombie also alleged its tax liability using separating reporting for the year in question would have been approximately $955,935. Based on these allegations, Abercrombie's prayer for relief requested "a refund of amounts paid of $181,591," which is the difference between its calculation of the tax liability under each reporting method. Abercrombie's allegations and prayer for relief did not seek damages relating to higher administrative expenses for record keeping and tax return preparation.

B. Invalidating Separate Reporting by Intrastate Businesses

The prayer for relief in Abercrombie's complaint did not request the portion of section 25101.15 giving intrastate unitary businesses a choice of reporting methods be struck down as unconstitutional. Such a remedy would have eliminated any facial disparity in treatment by no longer allowing separate reporting by intrastate unitary businesses. As a result, all unitary businesses, whether intrastate or interstate, would use combined reporting.

At oral argument, counsel for Abercrombie asserted the appropriate remedy included eliminating the favored treatment for intrastate businesses, which would allow the Board to pursue additional taxes from intrastate businesses that used separate reporting in tax years within the four-year statute of limitations. In addition, counsel for Abercrombie argued separate reporting should be extended to Abercrombie for the tax year in question because no other remedy is available for that year.

We do not decide whether the portion of section 25101.15 that gives intrastate unitary businesses the option of choosing separate reporting should be struck down as unconstitutional. (See *Esparza v. KS Industries, L.P.* (2017) 13 Cal.App.5th 1228, 1237-1238 [appellate courts do not consider issues raised for the first time on appeal when the opposing party could have presented additional evidence relevant to that issue if it had been raised in the trial court].) This remedy was not requested in the complaint. Furthermore, Abercrombie has provided no citations to the record showing this remedy was requested during the trial court proceedings. Had this remedy been raised below and the motion for judgment at the close of Abercrombie's case-in-chief been denied, the Board would have been able to present evidence addressing its burden under the strict scrutiny test.[4]

C. Legal Principles Applicable to Abercrombie's Chosen Remedy

In *Macy's Dept. Stores, Inc. v. City & County of San Francisco* (2006) 143 Cal.App.4th 1444 (*Macy's*), the court addressed the remedy available to a taxpayer that establishes a violation of the commerce clause. Relying on *McKesson Corp. v. Florida Alcohol & Tobacco Div.* (1990) 496 U.S. 18 (*McKesson*), the court stated the taxing

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4 In *Harley II*, the trial court concluded the Board carried its burden by demonstrating California had a legitimate interest in requiring combined reporting for interstate unitary businesses to (1) accurately measure and fairly apportion the income from all functionally integrated entities and (2) prevent the manipulation and hiding of taxable income. (*Harley II*, *supra*, 27 Cal.App.5th at pp. 251, 256.) As a result, the Fourth District granted the Board's motion for summary judgment.

authority could cure the invalidity of the tax scheme by refunding to the taxpayer the difference between the tax paid and the tax that would have been assessed if the taxpayer had been extended the same preferential treatment as its competitors. (*Macy's*, *supra*, at p. 1450.) The court concluded this remedy was consistent with the dictates of the commerce clause. (*Ibid*.)

Abercrombie's request for a refund is consistent with the general description of the remedy given in *Macy's*—that is, a refund of the difference between the tax paid and the tax that would have been assessed under the treatment allowed its intrastate competitors. (*Macy's*, *supra*, 143 Cal.App.4th at p. 1450.) The disagreement over Abercrombie's recovery of a refund is not based on a legal dispute about the general statement of the formula for determining the amount of the refund. The Board accepts that a refund is an appropriate remedy to equalize treatment between interstate and intrastate unitary businesses for a violation of the commerce clause. The dispute focuses on whether Abercrombie proved a *nondiscriminatory* use of separate reporting would have reduced its tax liability for the year in question. Stated another way, how should "separate accounting" be applied to an Abercrombie, an interstate unitary business, to eliminate the disparate treatment and, thus, provide evenhanded treatment to both interstate and intrastate unitary businesses?

D. Trial Court's Decision

The trial court's statement of decision addressed Abercrombie's request for a refund by stating Abercrombie failed to meet is burden of showing the alleged discrimination caused the damages it claimed. The trial court cited *McKesson* and accepted Abercrombie's contention that the appropriate remedy was to allow Abercrombie to recompute its tax burden using separate accounting. The court, however, was not convinced Abercrombie's recomputation of its tax liability went no further than eliminating disparate treatment.

1. The Refund Claimed

Abercrombie supported its claim to a refund for the tax year in question by presenting the testimony of Reddick and Pedersen and various exhibits, including a document showing the refund Abercrombie believed it was due. The court evaluated the evidence and concluded the tax savings claimed "resulted from Abercrombie's proposed non-reporting of the income of most of its subsidiaries under a 'separate reporting' scenario." The court determined Abercrombie was not entitled to the tax savings claimed. First, the benefit Abercrombie sought under separate accounting was derived from the omission of income from subsidiaries whose income appeared in Abercrombie's report of unitary income. The court found this type of exclusion of income derived from California was something an in-state business could never do because all of an in-state business's income would be reported in California, regardless of whether separate or combined reporting was used. In effect, the court found Abercrombie's proposed use of separate reporting did not provide a level playing field. The court stated:

> "Abercrombie's proposed scheme would result in favorable rather than equal treatment to businesses such as Abercrombie. For example, the evidence here showed that Abercrombie had a Delaware corporation receiving payments from the Abercrombie subsidiary operating stores in California for the use of Abercrombie's intellectual property. Under Abercrombie's 'separate accounting' scenario, income from California sales that was spent on licensing the unitary business' own intellectual property would effectively be deducted from taxable business income, an option unavailable under the method known as 'separate reporting' available to in-state businesses."

This is the type of "manipulation and hiding of taxable income" avoided by requiring combined reporting for interstate unitary businesses. (*Harley II*, *supra*, 27 Cal.App.5th at p. 256.) This tax avoidance technique is not available to a group of entities operating within California and using separate reporting because all of the entities file California tax returns. In short, Abercrombie's proposal omitted significant unitary business income attributable to its California business activity, which was a possibility not available to an intrastate unitary business. Therefore, the refund claimed by Abercrombie did not address disparate treatment caused by separate reporting being available only to in-state businesses, but sought to use separate reporting to gain an advantage over those businesses.

Abercrombie's appellate briefing does not address the court's finding about the underlying source of the tax refund claimed and show that finding was erroneous under the finding-compelled-as-a-matter-of-law standard. (See Dreyer's, *supra*, 218 Cal.App.4th at p. 838.) For instance, Abercrombie has not shown all of the income attributable to California under the unitary business principle was still reported under its proposed recalculation of its Californian tax liability.

2. Hypothetical Impacts

The trial court noted Pedersen testified "as to a number of hypothetical ways in which a unitary business might benefit from choosing to file on a separate basis in the year at issue, primarily due to differing applications of tax credits and loss carryovers to combined and separate filers." Pedersen, however, was unable to provide an example of how these hypothetical differences resulted in Abercrombie paying more taxes than it would have under separate reporting.

Earlier in the proceedings, the trial court reached a similar result in denying the cross-motions for summary adjudication. The court acknowledged Pedersen had identified four ways in which interstate unitary businesses might bear a higher tax burden under combined reporting, but concluded Abercrombie had not presented evidence showing any of these four issues required Abercrombie to pay a higher tax in the year in question.

On appeal, Abercrombie has not argued or shown that one or more of these four advantages of separate reporting could have been used to lower its tax liability for the year in question. For example, based on Reddick's testimony, the court explicitly found

"Abercrombie did not suffer any loss of tax credits [or] loss of loss carryover benefits as a result of combined filing." Furthermore, Abercrombie has not shown its evidence was so strong that the trial court was compelled as a matter of law to find all or part of the refund claimed related to a more effective application of tax credits and net operating loss carryovers under its use of the separate reporting method. (See Dreyer's, *supra*, 218 Cal.App.4th at p. 838.) Consequently, Abercrombie did not show the advantages of separate reporting the court characterized as hypothetically available were actually available to it and, thus, a basis for some or all of the refund claimed.

3. Administrative Costs

The trial court also evaluated the possibility of awarding damages to Abercrombie based on the higher administrative expenses associated with combined reporting, such as the higher cost of compiling a combined return rather than separate returns. The court stated, "Abercrombie did present testimony that it cost up to $2,600 [to] file a combined return, and [it] would have cost only around $300 for each separate return." Abercrombie asserted it would have been required to file only one separate return and, therefore, separate reporting would have saved it $2,300. Abercrombie also asserting the complicated nature of combined reporting (1) created a need to retain records for up to 10 years, instead of the three or four years for separate report records and (2) made it more difficult to accurately predict estimated tax payments, an uncertainty that was addressed by making larger estimated payments than necessary.

The court rejected the theory that Abercrombie had proven an entitlement to damages based on increased administrative costs because it had not been pleaded. Instead, Abercrombie sought only a tax refund and "it was acknowledged by Abercrombie that none of these issues had been a factor in determining its tax liability for the year at issue."

4. Other Financial Impacts

The court addressed Pedersen's testimony that separate reporting might allow for a reallocation of tax liability among the entities comprising a unitary business, which might be an advantage when seeking to sell or spin off a portion of its business. The court stated that Pedersen acknowledged that a potential buyer performing due diligence would be able to look through the separate accounting at the relationship between the member entity and the rest of the unitary business. The court determined this possible difference in outcome was purely conjectural. Furthermore, like increased administrative expenses, this potential impact was not a factor in Abercrombie's recalculation of its tax liability for the year in question.

E. Proper Calculation of Refund

Abercrombie's reply brief urges this court to "reject [the Board's] claim that Abercrombie's remedy should be to 're-calculate its tax under the same rules applicable to an entirely intrastate unitary business.'" In Abercrombie's view, the Board's "argument is based on the already rebutted argument that the alternative afforded to intrastate unitary groups is taxation of 100% of their income."

Based on *McKesson* and *Macy's*, we conclude discrimination violating the commerce clause may be cured by refunding to the taxpayer the difference between the tax actually paid and the tax that would have been assessed if the taxpayer had been extended the same preferential treatment as its intrastate competitors. (*Macy's*, *supra*, 143 Cal.App.4th at p. 1450.) This is the general rule of law that defines the refund to which Abercrombie would be entitled if (1) it had established a commerce clause violation and (2) the state failed to establish a legitimate state purpose. The specific question presented by this general rule is how to apply "separate accounting" to Abercrombie, an interstate unitary business, in a manner that eliminates the disparate treatment and, as a result, is favorable to neither interstate nor intrastate unitary businesses. (See pt. III.A., *ante*.)

Abercrombie's broad argument that it should not be required to recalculate its tax liability under the same rules applicable to an entirely intrastate business does not take account of (1) the finding of fact that application of its refund calculation provides it an advantage not available to intrastate unitary businesses and (2) its failure to demonstrate that finding of fact was erroneous. The advantage sought by Abercrombie is the reduction of income subject to taxation by California, which is accomplished by not reporting income that otherwise would be treated as derived from or attributable to sources within California. This technique of not reporting income properly apportioned to California creates, rather than eliminates, disparate treatment. As a result, Abercrombie has not shown its calculation of the refund complies with the rule of law defining the appropriate refund. (See Macy's, *supra*, 143 Cal.App.4th at p. 1450.)

In summary, Abercrombie failed to demonstrate the trial court erred in its findings of fact or its legal analysis of how to calculate a refund that would cure the disparate treatment of interstate unitary businesses.

DISPOSITION

The judgment is affirmed. The Board shall recover its costs on appeal.

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SMITH, J.

WE CONCUR:

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LEVY, Acting P.J.

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PEÑA, J.