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Supreme Court of Texas.
Allcat Claims Service, L.P. and John Weakly
v.
Susan Combs, Comptroller of Public Accounts of The State of Texas, and Greg
Abbott, Attorney General For The State of Texas.
No. 11-0589.

October 24, 2011.

Appearances:

James F. Martens of Martens, Seay and Todd, for Petitioners; Christopher S. Johns of Dawson & Sodd, LLP, for Amicus Curiae.
Danica Milios of the Office of the Attorney General, for Defendants.

Before:

Chief Justice Wallace B. Jefferson; Nathan L. Hecht, Dale Wainwright, David M. Medina, Paul W. Green, Phil Johnson, Don R. Willett, Eva M. Guzman, and Debra H. Lehrmann, Justices.

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CHIEF JUSTICE WALLACE B. JEFFERSON: Good morning. The Court has one matter on its docket this morning. It's a case of original jurisdiction 11-0589 Allcat Claims Service, L.P. and John Weakly v. Susan Combs, Comptroller of Public Accounts for the State of Texas and Greg Abbott, Attorney General for the State of Texas. The Court has allotted a total of one hour for arguments, 24 minutes for the Plaintiffs, 30 minutes for the Defendants and six minutes for the Amicus Curiae. These proceedings are being recorded and there will be a link to the arguments posted on the Court's website by the end of the day today. The Court is ready to hear argument in 11-0589.

MARSHAL: May it please the Court, Mr. Martens will present argument for the Plaintiff. Mr. Johns will present argument for the Amici. The Plaintiff has reserved seven minutes for rebuttal. Mr. Martens will open with the first 17 minutes and will present the rebuttal.

ORAL ARGUMENT OF JAMES F. MARTENS ON BEHALF OF THE PETITIONER

ATTORNEY JAMES F. MARTENS: Good morning, may it please the Court. The central issue is whether the Texas franchise tax violates the Bullock Amendment, which, by its plain text, prohibits a net income tax on a natural person's share of partnership income. My intent is to have my Amici Counsel address the jurisdictional issues and I would like to turn directly to the merits of the Bullock Amendment challenge. Allcat wins this case because this is a tax that is imposed on a natural person's share of partnership income and it is a net income tax. Turning to the first issue, based on the plain text Allcat wins, the State steers the Court away from the plain tax

of this amendment and would have the Court rewrite it and they would have the Court first cross out the including phrase.

JUSTICE EVA M. GUZMAN: Can I ask you please? How do you reconcile your theory with the legislature's express adoption of the entity theory under the TRPA?

ATTORNEY JAMES F. MARTENS: Your Honor, at the time the Bullock Amendment was adopted, another provision with the Texas Business Organizations Code was adopted at the same time and this is a more narrow provision and it is 152.202(a). That provision states that, partners are credited with their shares of partnership income and that crediting occurs as those profits are earned. That position is further consistent, our position is further consistent with the structure of Article 8, Section 1 (c) of the Texas Constitution, which divides Texas taxpayers into two groups, natural persons and corporations not including municipal, and this provision expressly references the Bullock Amendment. It was changed at the time the Bullock Amendment was adopted to reference it and what happens is entities in Texas fall into one of two categories, natural persons or corporations and there simply is no provision for partnerships or any other form of entities. Instead, we look to the members or the partners and see where they fall.

JUSTICE PHIL JOHNSON: Of course, doesn't Article 17 say that the state has the right to tax, it's not limited to the subjects and matters, I think is whatever that language is. It gives the state the other right to tax other than what is specifically authorized does it not?

ATTORNEY JAMES F. MARTENS: Yes, Your Honor, it does, but that Section 17 continues to say consistent with the principles of taxation announced in this chapter. The American Transport case talks about the principles of taxation and they refer back to Section 1, Article C, -- Section 1, Subsection c of Article 8, which is what we were just discussing. So while they argued on the power to expand the subjects and the objects, that is limited to the principles of taxation, Article 1(c).

JUSTICE DAVID M. MEDINA: Now I understand your argument, you're saying this is just an in-the-round the Bullock argument because these persons that are, these partnerships when they're broken up, individual tax basis, they become natural persons. Explain that to me.

ATTORNEY JAMES F. MARTENS: Oh, yes, sir. Yes, Your Honor.

JUSTICE DAVID M. MEDINA: How these -- it's a tax on a natural person.

ATTORNEY JAMES F. MARTENS: As a partnership generates revenues and incurs expenses, it generates income and that income is divided up to the partners as it is earned. It is immediately put into shares. If you look into the partnership's records, there's not an account called, partnership income. There are individual accounts, like the savings accounts I alluded to, inside the partnership's books that break that income up among the individual partners and I think if you look at an illustration of that is in the exhibits that we provided for Allcat. I believe it's Appendix 6, page 7 and it is the reflection of the partnership's books that comports with the arguments that I make. The word "share" is important because share refers to a larger whole and that whole is the partnership income and if you tax the larger whole, the partnership income, you are taxing the person's shares. Representative Hury back in 1991 tried to do this. He tried to impose a tax on partnerships and when he did that, Bob Bullock and a majority of the Senate rejected that proposal and substituted instead sweeping occupation taxes that apply to about 20 categories of the broad professionals in this state. In the course of drafting the Bullock Amendment and that prior history, Lt. Governor Bullock stated, "a tax on partnership income is really a tax on personal income" and what he means by that is if you go to Section 152.202(a), which immediately credits partners with their shares of income as that income is earned, if you do that, the partners are attributed their income in that moment as it is earned.

JUSTICE DAVID M. MEDINA: But aren't they also provided some protections from their losses and does that

need to be considered imbalanced?

ATTORNEY JAMES F. MARTENS: Your Honor, the answer is no. The plain text of the Bullock Amendment says, nothing about business entities. It says, nothing about limitations of liability and that's not even a true statement under the revised franchise tax. We tax general partnerships. No partner in a general partnership has limited liability protection. So too with trusts that don't have spendthrift provisions. They face unlimited liability, the beneficiaries do, and so that division mark is not real and it shouldn't even be applied because you'd have to rewrite the Bullock Amendment to get there. As to business entities, business entities include sole proprietorships. We know that from the bill analysis to Hury's bill and if you rewrite the Bullock Amendment to focus on business entities, then you've gutted it completely and you would be allowing the state to then tax the net incomes of natural persons because they would own business entities that are sole proprietorships.

JUSTICE PHIL JOHNSON: Let me ask you a question. On your exhibits, you have attached a copy of the 1065 Return of Partnership Income.

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE PHIL JOHNSON: And under there, there are sections. There's a section called "income" and it goes down and adds up gross receipts, less returns and allowances, etc., etc. It gets down to total income. It has a line called, total income.

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE PHIL JOHNSON: Then we go to another section called, deductions-repairs and maintenance, rent, taxes and licenses, things like that.

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE PHIL JOHNSON: Alright. So when is it that the partnership, when is it that the partnership income is divided into shares? At the income level? Or at the after the deductions? Because after the deductions we call it ordinary business income but is it the total income? Is the ordinary business income? How do we know at what point it's divided into shares?

ATTORNEY JAMES F. MARTENS: Your Honor, the division into shares happens as revenues come in and conceptually happens as revenues come in and expenses are paid out.

JUSTICE PHIL JOHNSON: So revenues - so is it your position as revenues come in, those are divided into shares?

ATTORNEY JAMES F. MARTENS: They are because profits, a partner's share of profits, which is what 152.202(a) references is a calculation of revenues minus expenses. We can illustrate this pretty easily with a law firm partnership. If you work for a law firm and you leave mid-year and you're in a partnership, you have your own individual capital accounts that are recorded on the partnership's books. At your date of exit, you are entitled to your profits. You're entitled to cash distributions because your income has accrued up to that point, which brings another point and that is the State's position conflates the earning of income with the distribution of cash. Those are two fundamentally different concepts. Income is a flow concept of revenues coming and expenses going out. Cash distributions occurs when the partnership writes the checks. Now, the cash distributions may come from profits, or they may come from -- but they may be a return of prior capital contributions. They may be funded by borrowings of the partnership themselves--

JUSTICE PHIL JOHNSON: Well, let me-

CHIEF JUSTICE WALLACE B. JEFFERSON: But is it possible for the partners to have no income because the partnership lost money and yet under the tax structure that we're looking at today, the partnership still has to pay tax, the franchise tax. In other words, is it really an income tax when a partnership that loses money is still obligated to pay the tax.

ATTORNEY JAMES F. MARTENS: Good point, Your Honor. No state has ever adopted a definition that says, it's not an income tax if you don't have to pay it. We know that it's very easy to have to pay the federal income tax to have federal taxable income, but have lost money. Like, for example, say I am a salesperson and I want to really develop my business so I spend a lot of money on meals and entertainment more so than the revenues I take in in commissions. Well, the federal system only allows me a deduction for half of my meals and entertainment. So I would have taxable income yet I would have lost money. Same thing happened with the earned surplus tax. That is, the old unearned surplus tax did not allow deduction for officer and director compensation. So if a corporation, like a lot of them do, were to try to pay out their earnings at the end of the year as officer and director compensation to drive their taxable income down to zero, when they turned around and completed their old earned surplus tax forms, they'd have tax to pay because there is no deduction under the old earned surplus tax for that and everybody recognizes that the old unearned surplus tax and our federal income tax regimens are both income taxes so the measure-

CHIEF JUSTICE WALLACE B. JEFFERSON: So -- but so it's an income tax to the partner even though the partner doesn't have to pay any tax because there's been no distribution and the partnership lost money? I don't understand that logic.

ATTORNEY JAMES F. MARTENS: Well, the point I'm trying to make is that when we're talking about what constitutes net income, we look at dictionary definitions and legal definitions and no state has ever come up with a theory that if you have negative cash flow that you don't owe a tax. If you look at the tax structures among the variety of states, what they have in common is they all start with collective revenues and then as a matter of legislative grace, they decide the deductions they are going to allow. The federal system doesn't allow a lot of deductions. The old surplus tax doesn't allow deductions for one of the largest categories, officer and director, and so it is not how far you go with deductions that makes a net income tax on that income tax. The common thread through that is you start with revenues. You apply deductions. Exemptions are our hallmark and you arrive at a tax base. Net means your revenue's minus net of something because if you could go with the theory that said, well, if we don't allow enough deductions, look at the results that you'd have. We'd be saying maybe Texas voters cared about a tax structure. They wanted to vote on a tax structure that took all of their revenues minus all of their deductions, but they couldn't care less about a tax structure that took all of their revenues and didn't give them all their deductions.

JUSTICE DON R. WILLETT: Mr. Martens, going back to what theory applies to partnership income entity versus aggregate, the legislature has twice adopted statutes now that, at least the state contends, seems to indicate pretty clearly the state's adoption of entity theory broadly, including a partnership is an entity distinct from its partners and second, a partner is not a co-owner of partnership property and your best response is what?

ATTORNEY JAMES F. MARTENS: Is that the partnership as a legal entity is confined to certain attributes of partnerships, creditors rights, property and see it is when you conflate income with property of the partnership that you wind up with the fallacy of their position and that is true, the property belongs to the partnership, but the income belongs to the partners and sharers.

JUSTICE DON R. WILLETT: What about the other statute? A partnership is an entity distinct from its partners.

ATTORNEY JAMES F. MARTENS: That is, first, that is a broad statute as contrasted with the narrow 152.202(a). 152.202(a) talks about partners are credited with their share of profits. It is a carryover from the old partnership statutes that it was done at the very same time the Bullock Amendment was adopted. So our legislature knew at the time they adopted or wrote the Bullock Amendment that 152.202(a) was in the business code

and it reads in parallel, both terms using share of profits, partners' share of profits and if we go back to just a plain text reading of the statute, it says, nothing about separate legal entities. It talks about division of income. It is not a, the Bullock Amendment is not a statute that is geared towards entities. It is a statute that talks about income.

JUSTICE DON R. WILLETT: So your position is the entity theory applies to certain aspects of partnership law, but in terms of partnership income, the Court should stick to the aggregate theory?

ATTORNEY JAMES F. MARTENS: Right, the court should follow the plain text of the Bullock Amendment. It should follow the partnership provision 202(a) and it should respect the principle of income taxation under Section 1(c) of Article 8, which divides Texas taxpayers into natural persons and corporations and take the partners of the entity and using the aggregate theory followed under 202(a), put them into one of those two categories.

CHIEF JUSTICE WALLACE B. JEFFERSON: Do you think the legislature intended an unconstitutional act with this? I mean the whole purpose was as both parties have agreed was to find some solution to the public school finance crisis and find another source to fund our public schools. Do you think that when they wrote this statute, they intended to violate the constitution or find a way consistent with the constitution to affect that purpose?

ATTORNEY JAMES F. MARTENS: Your Honor, I don't know because the legislative history is fairly dearth, but if you look at what they wrote, they wrote sort of in Orwellian fashion. This is not a net income tax, meaning that they clearly had in their mind a concern about what this was and I believe that they wrote that without thinking about the U.S. Supreme Court precedent and this Court's, I think, precedent. That says, we look at the nature and effect of a tax. We don't look at the labels that the legislature gives it that a tax on sleeping measured by shoes in a closet is still a tax on shoes.

CHIEF JUSTICE WALLACE B. JEFFERSON: So you think they intended to immunize all partnership income from taxation and if that's the case, then weren't there figures or all the actuarial data that they looked at in determining how much money this is going to bring into the system was completely inept or what?

ATTORNEY JAMES F. MARTENS: Well, we know that the estimates versus actually what came in are very, very far off, that the tax has not brought in that much. I would say that, yes, I think you're right that if they had factored in the need to remove from the tax base that portion of the tax that was imposed on a natural person's share of partnership income, if they were able to calculate that and pull it out, the numbers would have been lower.

JUSTICE DON R. WILLETT: For you to prevail, do we have to adopt the Internal Revenue Code's attitude toward partnership income?

ATTORNEY JAMES F. MARTENS: Oh absolutely not. And that is something else that we have not said. I have not stood on the Internal Revenue Code at all. The books that I gave the Internal, the tax return that I gave you was merely meant to show you the capital accounts. Our position is rooted solely in the Bullock Amendment itself, 151.202, it's construction with Article 1c and we don't go to the Federal Income Tax. I see my time is out.

JUSTICE PHIL JOHNSON: Chief, may I ask?

CHIEF JUSTICE WALLACE B. JEFFERSON: Yes, Your Honor.

JUSTICE PHIL JOHNSON: Two questions, in your reply brief, you modify the relief you're seeking apparently to only that income allocable to natural persons, is that correct?

ATTORNEY JAMES F. MARTENS: Your Honor, that is correct. We only seek relief to the extent the tax is applied to a natural person's share of partnership income.

JUSTICE PHIL JOHNSON: Such as Mr. Weakley?

ATTORNEY JAMES F. MARTENS: Such as Mr. Weakley, exactly.

JUSTICE PHIL JOHNSON: You may have limited partners in Allcat who are not natural persons, I take it?

ATTORNEY JAMES F. MARTENS: Yes, that's correct. We have one corporate partner and the relief is not properly extended to that entity.

JUSTICE PHIL JOHNSON: Secondly, let me go back to where I was to start with on the 1065. Is it your position that the revenue, the income is allocable to the partners or is it your position that the ordinary business income is allocable to the partners and sharers?

ATTORNEY JAMES F. MARTENS: Well, I'd like to use the word [inaudible]. Excuse me.

JUSTICE PHIL JOHNSON: The revenue of the partnership or the business income of the partnership, which is allocable?

ATTORNEY JAMES F. MARTENS: The profits, the share of partnership profits under 152.202(a). The --

JUSTICE PHIL JOHNSON: That would be on this tax return, the ordinary business income, I take it?

ATTORNEY JAMES F. MARTENS: Well, I don't -- I do not believe that a partner share of profits as defined under 152.202(a) necessarily finds its way on to that tax return. That is a book calculation where the partnership goes into its books using economic deductions, but if you want to draw the equivalent to that, the equivalent of what gets divided would be the bottom line taxable income figure. Note though that the Bullock Amendment speaks to net income, not revenue taxable income.

JUSTICE PHIL JOHNSON: The revenue, taxable income being revenue less deductions.

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE PHIL JOHNSON: Thank you.

CHIEF JUSTICE WALLACE B. JEFFERSON: Justice Wainwright.

JUSTICE DALE WAINWRIGHT: In Chapter 171, Subsection 002(b), the legislature excluded general partnership from the definition of taxable entity. Is it fair to conclude the legislature intended limited partners to remain within that definition then?

ATTORNEY JAMES F. MARTENS: I believe so and note that, I'm sorry.

JUSTICE DALE WAINWRIGHT: And that's the unconstitutional act.

ATTORNEY JAMES F. MARTENS: The unconstitutional element is imposing this tax on any natural person's share of partnership income regardless of whether they're general or limited partners. If you and I are in a partnership, 49% partners a piece, and we have a 2% corporation enter or actually a 2% general partnership enter the picture. So it's 49, Your Honor, 49 me and 2% another general partnership. The entire general partnership's

revenues, tax base, is subject to the franchise tax even though there is no limited liability among us and even though that general partnership that may have entered might be another partnership in which you and I are 50/50 partners and the comptroller has ruled publicly on that that is the consequence.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions? Thank you, Counsel. I will hear from the Amicus Curiae.

ATTORNEY CHRISTOPHER S. JOHNS: Good morning, Mr. Chief Justice, may it please the Court. The Court has the jurisdiction to decide this constitutional challenge. As former Chief Justice Greenhill recognized, in 1980 amendments to Article 5 expanded the Court's inherent constitutional powers, which are now limited only by specific constitutional provisions and the Supreme Court [inaudible] --

JUSTICE NATHAN L. HECHT: But the examples he gave were control of state bar and the board of law examination. He didn't use extraordinary writs as another example of that. So where do we get the jurisdiction for that?

ATTORNEY CHRISTOPHER S. JOHNS: Yes, the 1980 amendments crossed out the words, the Supreme Court shall have appellate jurisdiction only as except as otherwise specified. Now it's, the court shall exercise the judicial power of the state as expressly specified so it took out the limitation on the court's jurisdiction being appellate only so I think you have to look at Article 5, Section 3 in tandem with Section 8, which says that, the district courts shall have original and exclusive jurisdiction except where the constitution or other law confers the jurisdiction on another court. HB3 is such another law. It provides this Court the power to issue declaratory and injunctive relief in a challenge, a constitutional challenge to this statute.

JUSTICE NATHAN L. HECHT: I'm unclear whether you think that by removing the restriction in the first sentence of Section 3, the court now has essentially unlimited jurisdiction or whether you think under Section 8, it's dependent on some statute by the legislature.

ATTORNEY CHRISTOPHER S. JOHNS: I think it's dependent on, as the text says, except where the constitution provides for original jurisdiction or where some other law, such as HB3, would provide for original exclusive jurisdiction.

JUSTICE DEBRA H. LEHRMANN: Can I ask you, what about the language the legislature may confer original jurisdiction on the Supreme Court to issue writs of quo warranto and mandamus as such cases as may be specified except as against the governor. Doesn't that imply that it's limited to those areas?

ATTORNEY CHRISTOPHER S. JOHNS: Well, I think it was important that the constitution retain that. It says, the legislature can, may provide original jurisdiction over those writs, but keeping that language in there was important because it maintained the restriction on not being able to issue such writs against the governor. Just --

JUSTICE DEBRA H. LEHRMANN: I mean, reading it, it seems to imply that those are the only things that the legislature can confer. Can you just respond to that?

ATTORNEY CHRISTOPHER S. JOHNS: I think the word "may" says, you may do it. I don't think that's providing an exclusive list, but I do think it's providing it's retaining an important limitation on the legislature's ability to confer original jurisdiction as to such writs against the governor.

JUSTICE DEBRA H. LEHRMANN: Why would they just specify those two particular things?

ATTORNEY CHRISTOPHER S. JOHNS: It's a carryover from what existed there before. I agree with that and under the court's interpretations of this part of the constitution in Lane and in Love, the explanation was well

this says, we may confer original jurisdiction just here and there was a limitation in those earlier cases that the court's jurisdiction unless otherwise specified, and this would be an example of a specific allowance, otherwise it was limited to, it could not have original jurisdiction except where the constitution allowed it. Now the words appellate jurisdiction only are stricken and that has to mean something. So we think this concern about the constitutionality of the text is what led the legislature to provide, I think for the first time, original and exclusive jurisdiction on this Court to decide the constitutionality of a statute. I'd like to focus in my remaining time just on the State's positive case about what they think the including language of the amendment means. The State says, and their list of incomes goes something like this-salaries, wages, dividends, rents, interest received and partnership distributions. Well, partnership distributions don't as Mr. Martens said, don't necessarily have anything to do with income. I know that from personal experience in my law firm the first year that we operated. We made distributions, but those weren't from income. We didn't have much income the first few months that we operated. They were from capital contributions that we made that were put in a partnership account and so when distributions were made, they were not made from income. The State says that, there was a concern that the restriction in the including language is really about preventing the legislature from reclassifying partnership distributions as a type of business income that could be subject to a business tax. Well, that doesn't make sense as a matter of tax principles nor was it one of the evils ever mentioned in the discussion back in 1993 and the years leading up to it. Bob Bullock, whose name bears this amendment, said, the concern was that when you tax a partnership, composed of natural persons, you're really imposing a tax on those individuals and it wouldn't be acceptable to Texans to put an income tax on a person just because they derive income from a partnership than it would be to impose a broad tax on all Texans. So the court-

JUSTICE PHIL JOHNSON: Counsel, you're running out of time and you were going to address jurisdiction. There are two challenges made here. One is the facial challenge on the language and the other is the comptroller's interpretation and as it applies the language. You did not address that second part, I don't think, did you in your presentation? Maybe you did and I didn't get it.

ATTORNEY CHRISTOPHER S. JOHNS: I don't think I did, but I'm happy to answer that.

JUSTICE PHIL JOHNSON: Briefly, subject to the Chief Justice, I think, here.

ATTORNEY CHRISTOPHER S. JOHNS: HB3 says, it authorizes original jurisdiction over the challenge to the constitutionality of the franchise tax and that the relief is to issue an injunctive declaratory relief in connection with that challenge. One, I think if there are constitutional or other concerns about opening this up to [inaudible] challenge is I think that Section 24 could be read more as a facial-type challenge, such as in this case.

JUSTICE PHIL JOHNSON: But the challenge is to the comptroller's interpretation and the comptroller's applying of the language itself, is that correct?

ATTORNEY CHRISTOPHER S. JOHNS: My reading of this would be that I think the concern that the legislature had in allowing original --

JUSTICE PHIL JOHNSON: No, it's your challenge, your challenge is through the comptroller's interpretation of the language itself.

ATTORNEY CHRISTOPHER S. JOHNS: Of the Bullock Amendment?

JUSTICE PHIL JOHNSON: Yeah, the Bullock Amendment and the franchise tax.

ATTORNEY CHRISTOPHER S. JOHNS: Well, to that extent, we think the challenge is really a facial-type challenge, can you impose an income tax on a person's share of partnership income. We think that's a legal question for this Court to decide.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions?

ATTORNEY CHRISTOPHER S. JOHNS: Thank you.

CHIEF JUSTICE WALLACE B. JEFFERSON: Thank you, Counselor. The Court is ready to hear argument from the Defendants.

MARSHAL: May it please the Court, Ms. Milios will present argument for the Defendants.

ORAL ARGUMENT OF DANICA MILIOS ON BEHALF OF THE RESPONDENT

ATTORNEY DANICA MILIOS: Good morning and may it please the Courts. Plaintiff's constitutional challenge is precariously built on a fundamental misunderstanding of Texas partnership law. Texas treats partnership income as separately owned while it is held by the partnership until it is distributed to the partner.

JUSTICE EVA M. GUZMAN: What language in the Texas Revised Uniform Partnership Act embraces the entity theory as to income as well? Is there any specific language that we can look to?

ATTORNEY DANICA MILIOS: There is nothing in the Revised Partnership Act and which is now codified in the Business Organizations Code that explains the nature of partnership income. The provision that Mr. Martens has discussed with the Court, 152.202, talks about a partner's share of partnership profits. That makes sense. Partnerships and business entities earn profits. They incur losses, but nowhere in the Business Organizations Code are you going to find a definition of partnership income, but I would submit that there are several clues that the Court can look to to understand how partnership income is treated. First, as we have discussed, the Business Organizations Code plainly says, we adopt, we here in Texas adopt the entity theory of partnerships. Partnerships are separate entities from their partners. Back in 1993, when that the Texas Revised Partnership Act was adopted, commentators all agreed that the whole point of doing that was to make clear the entity theory prevails in Texas with two minor exceptions, being joint and separate liability of the partners for partnership debts and the duty of royalty partners owe each other. Now, let's talk about 152.202. That's talking about partnership profits. A partner is entitled to have his or her share of partnership profits credited to his or her capital account. Well, my sort of off-the-cuff response to that is so what? What does that mean about partnership income and how it's treated vis-a-vis the State? Still no answer. The Business Organizations Code does tell us how creditors can treat partnership income though. Section 153.256 explains that when a partner is a debtor and has a creditor who seeks to access the partner's income or the partner's assets, the creditor cannot access the income that is held by the partnership. Partnership income is protected by the Business Organizations Code. Now, a creditor can get a lien on a distribution. So once a distribution comes out of the partnership to the partner, the creditor can take it, but the creditor can't force that distribution and the creditor cannot access partnership income to pay the debts of the debtor partner. Strong indication that the legislature believes partnership income is something distinct, something separate. Of course, we also know that the legislature believes that partnerships are business entities that can be taxed because it's done so in the franchise tax. Now, Justice Guzman, I still haven't answered your question how do we know what partnership income is? Well, the courts have helped us out with that.

JUSTICE EVA M. GUZMAN: I guess the language was was there any expressed language in the Business Organizations Code and you've answered that we should look to these other factors in determining whether the legislature envisioned income as part of the entity theory.

ATTORNEY DANICA MILIOS: Exactly.

JUSTICE EVA M. GUZMAN: I think I know.

ATTORNEY DANICA MILIOS: And what we have from the legislature is what I've discussed so now, but I

would submit that still really doesn't answer the question, but the courts have helped us with that in divorce cases and a most recent opinion from the Austin Court of Appeals and the cite is 2011 SW2nd 4924073, none of the parties have cited that yet, the case is called, because it's so new. *Smith v. Grayson*. The Austin Court of Appeals does a very good job of explaining how the entity theory of partnership impacts and defines how the law views partnership income and I'm going to briefly give the Court some of the facts because it's very illuminating to think about what the Austin Court of Appeals is saying in relationship to what Mr. Martens argues 152.202 means. In *Smith v. Grayson*, Mr. Grayson was the partner. He had a separate interest in a partnership. In the partnership's books, Mr. Grayson had in his capital account a certain amount of the profits that he was entitled to have under 152.202. The partnership's profits were credited to his partnership, his capital account. The Austin Court of Appeals explains to us that a certain amount of that partnership earning had been distributed to Mr. Grayson during the marriage. So that was community property divisible by the divorce. However, the Austin Court of Appeals explains there was a portion of the partnership earnings that was held by the partnership, some \$18,000 that was credited to Mr. Grayson's capital account as it should be under 152.202, but nonetheless the Austin Court of Appeals held that partnership income is separate partnership income until it is distributed to the partner. Therefore, it was not subject to characterization as separate or community property and it wasn't subject to being divided at the divorce.

JUSTICE EVA M. GUZMAN: What precedent did they rely on that to reach that conclusion?

ATTORNEY DANICA MILIOS: The Austin Court of Appeals relied specifically on *Cleaver v. Cleaver*, which is a Tyler Court of Appeals opinion from 1963, which reached the same conclusion as well as a handful of other cases. I can't claim that there are dozens and dozens of these cases. It seems that in divorce, we probably try to do our best to avoid disrupting partnership situations, but nonetheless the cases are there and the Austin Court of Appeals unequivocally lets us know that partnership income for Texas is treated separately. So with that background understanding of what partnership law is, now we can look to the Bullock Amendment and understand what it means because the Bullock Amendment doesn't purport to define partnership law. It doesn't purport to define what a person's share of a partnership income is. It just says, the legislature can impose a tax on the net incomes of natural persons, including a person's share of partnership income, whatever that means, without a referendum, but now we know that because partnership income is separately viewed as partnership income until it is distributed, then a person's share of partnership income can't become his or her net income until it's in his or her bank account, until it's been distributed. It's a simple fact.

JUSTICE NATHAN L. HECHT: The problem I have with that is I can't fathom why you would stick that in there. Why would you write, you might as well write impose a tax on the net incomes of natural persons, including any stock dividends on General Electric stock. I mean, why single that out of all things?

ATTORNEY DANICA MILIOS: Right, well, the problem with the word including in the first place is that it tends to do that to us. We understand that the word "including" signifies that what follows is an illustrative, nonexclusive list. So by its nature, the word "including" tends to be extra, but we allow the legislature to do that. We allow the legislature to use the word "including" to say, hey, we're going to do a little more explaining here so that you can understand what we're talking about. I have two suggestions for why the legislature would have included that language. To begin, it prevents a tax on a distribution so that when that money is coming from or whatever the distribution is, if it's a cash distribution that is going into the net income of the partner, the legislature can't tax it without a vote.

JUSTICE NATHAN L. HECHT: But they couldn't even if the including wasn't in the constitution. Even if you left out including, you still couldn't tax it.

ATTORNEY DANICA MILIOS: Absolutely. Absolutely, because once it is-

JUSTICE NATHAN L. HECHT: Including adds nothing there. If you say you were going to give two explanations why stick it in there, but the first one is it accomplishes nothing.

ATTORNEY DANICA MILIOS: Well, it does accomplish something, Justice Hecht, because it is explaining to the reader that, well first of all to back up the truck a little bit, a natural person's net income, well what is that? That is your net income that you have in your bank account, including your share of partnership income. Well, obviously, we know from what the Plaintiffs have explained, there is concern at the time the Bullock Amendment was passed in 1993 that the Texas legislature would impose a tax on, it could impose a tax on natural persons. Bob Bullock believed in 1991 that imposing a tax on partnerships would be a tax on natural persons with all due respect to Lt. Governor Bob Bullock, that view is now wrong because the revised partnership act says that, partnerships are separate business entities, separate from their partners and we know from the way the balance of Texas law treats partnership that partnerships can, in fact, own separate property. And to get to your question, Justice Johnson, when a partnership submits its form 1065 to the federal government, right there is an acknowledgment that the partnership has income. The partnership is telling the federal government, here's my income. Now we all know that the federal government doesn't tax the entity. It passes it through to the partners, but that tax treatment is irrelevant to Texas' tax treatment.

CHIEF JUSTICE WALLACE B. JEFFERSON: What's the second reason? The legislature-

ATTORNEY DANICA MILIOS: Thank you, Chief Justice Jefferson. No, the second reason is simply that what Mr. Johns alluded to earlier that the legislature cannot reclassify peoples' income so the legislature can't reclassify rental income, stock dividends, partnership income and say, okay, that's business income. That's not the net income of a natural person. Now we can tax it and for that simple reason, it was important to include that in the Bullock Amendment.

JUSTICE NATHAN L. HECHT: But it seems to me the State's argument is that Governor Bullock wanted to not let you tax the partnership income while it was in the partnership, relating to the partnership, not just the distribution, that he didn't want that to happen, but he misunderstood partnership law and so even though he tried to write that, he didn't succeed. Is that the state's argument? If he had been right about the law, he would have done something different, but it turns out he was wrong about the law.

ATTORNEY DANICA MILIOS: Well, I certainly can't claim to be in the head of Governor Bob Bullock so I don't know what his true intent was.

JUSTICE NATHAN L. HECHT: And you wouldn't, you wouldn't want to.

ATTORNEY DANICA MILIOS: I wouldn't want to. You're absolutely right on that. Fortunately, we don't have to devise what Lt. Governor Bob Bullock was thinking. What we have to figure out is what the rest of the legislature was thinking. I would submit that it would be completely unreasonable to believe that on the one hand, the entire Texas legislature, while at the same time adopting the Texas Revised Partnership Act, which for essentially all purposes makes partnerships separate business entities from their partners, but at the same time, it was constitutionalizing the aggregate theory of partnership income without ever saying so without making that explicit.

JUSTICE DON R. WILLETT: Texas has certainly emblazed its own trail in matters of tax policy and other policy for better or worse, but there's no question, we're sort of distinct among the states, but can you tell me what other jurisdictions or states tax partnerships on an individual basis rather than as an entity.

ATTORNEY DANICA MILIOS: Justice Willett, I haven't done an extensive search, but I can tell you that the city of Philadelphia does and the District of Columbia does and in certain circumstances, New York does as well. I'd be happy to cite the cases that I've quickly found on that subject. The Philadelphia case is 692 A2d 246. The DC case is 764 A2d 798 and the New York case is 557 NYS2d 34. And while we're on the topic of whether partnerships just, in general, are recognized as being taxable entities, I would like to refer to the Court to yet another out of our state case from 1928, it's really good reading. The cite is 143 A, I wrote down 2d, but I think

it's A 656. The Maryland Court of Appeals goes through a very illuminating explanation of why it is that a state can, back in 1928, long before anybody thought of partnerships as being separate business entities, but nonetheless, the Maryland Court of Appeals explains why a state has the power to define a partnership as a separate business entity and then proceed to tax it and in fact, Maryland was an aggregate state at that time and Maryland had a constitutional provision that said, personal property has to be taxed at the site where the owner resides and partners in a partnership said, you can't tax my partnership where it is in its principal place of business because I reside over here in this other jurisdiction so you can't tax my partnership over there. You have to tax my partnership earnings to me the partner where I live and the Maryland Court of Appeals said, no, the legislature can redefine who owns this property and it has done so. This [inaudible] --

JUSTICE EVA M. GUZMAN: You --

ATTORNEY DANICA MILIOS: I'm sorry.

JUSTICE EVA M. GUZMAN: Go ahead, you can finish that sentence.

ATTORNEY DANICA MILIOS: The Maryland Court of Appeals simply held that the legislature had the power to define where the property was owned and what the character of the property was and therefore had the power to tax it.

JUSTICE EVA M. GUZMAN: You mentioned that the Form 1065 and the IRS treatment of partnership income is irrelevant to our analysis. Can you elaborate on that a little bit because there's been a lot of discussion about when partners take profits and what is income so why is that treatment so irrelevant?

ATTORNEY DANICA MILIOS: Well, it's irrelevant because the State of Texas can define partnership income differently than the way the federal government defines partnership income and getting back to I think what Mr. Martens was trying to explain with regard to Section, Article A, Section 1c of the Texas Constitution, Mr. Martens makes an argument that Texas can't tax partnerships because they're not listed in that provision. We would submit that that provision has been in the constitution since essentially the beginning when, of course, partnerships were not considered to be anything and the Texas Constitution doesn't use the word incorporated entity. It says, natural persons and corporations. If you look in Black's dictionary, corporations just means a legal entity recognized by the state. So the State of Texas has the authority to define property rights. It has the authority to define business entities that are allowed to exist in the state and how they're treated. So --

JUSTICE NATHAN L. HECHT: And if partnerships were treated under the aggregate theory, would the State lose this case?

ATTORNEY DANICA MILIOS: Absolutely.

JUSTICE NATHAN L. HECHT: So what do we do then with unincorporated associations? Are they treated as an entity or as aggregates?

ATTORNEY DANICA MILIOS: That is a real good question, Justice Hecht, and I don't know the answer to it. I don't know the answer to that.

JUSTICE NATHAN L. HECHT: Why should we treat one different than the other?

ATTORNEY DANICA MILIOS: I would say that the unincorporated association, if it's not recognized by the State of Texas as a separate entity, probably wouldn't be able to be taxed anyway so if something like a sole proprietorship, for example, is an unincorporated association of one, the State of Texas doesn't recognize that as a separate entity so contrary to what Mr. Martens was arguing, the State of Texas can't tax a sole proprietorship's net income without offending the Bullock Amendment.

JUSTICE NATHAN L. HECHT: Well, we do have in the law joint ventures and different things and there's some confusion about whether they're a partnership or not and maybe sometimes they're not, but if there were a joint venture different from a partnership, you think the State might not be able to tax it.

ATTORNEY DANICA MILIOS: It would certainly depend on how the State defined that property interest, that's right. We have to go back to the background rule that the State gets to define property interests so if there were a joint venture where the State recognized or didn't recognize it as a separate entity, then I think a good argument could be made that the State couldn't tax that venture without a vote of the population.

JUSTICE DON R. WILLETT: Did I hear you say earlier that you believe that our case law or Texas case law indicates that we always apply the entity theory across the board in matters of partnership law?

ATTORNEY DANICA MILIOS: With the exception of, there are two provisions in the Business Organizations Code that seem to still reflect the aggregate theory and that is the provision that requires partners to have joint and several liability for partnership debts and the provision dealing with the duty of loyalty that partners owe each other, but other than that it is, I have not come across the situation where a court in Texas has since 1993 applied the aggregate theory to partnerships.

JUSTICE DON R. WILLETT: But have you come across case law from either this Court or courts of appeals that where the court analyzes partnership income through the entity theory lens?

ATTORNEY DANICA MILIOS: Well, certainly. In *Smith v. Grayson* that I was just discussing, in *Cleaver v. Cleaver*, this Court did discuss the partnership, the entity theory of partnership in *McKnight v. McKnight*. That was another divorce case, but of course, that was before the Texas Revised Partnership Act was adopted, but the court recognized in that case that, again, it's in a divorce case that the divorcing non-partner spouse didn't have a right to access the partnership income while it was held by the partnership. There was discussion in that case, I would submit, is slightly off topic when the court talks about potentially forcing a distribution or a cutting up of the partnership interest in that case. That, obviously, would not be correct now in light of the fact that the entity theory of partnership has fully been adopted. And then, of course, there are a handful of other cases and they are cited by the Austin Court of Appeals case in *Smith v. Grayson* that, again, are divorce cases that talk about how the entity theory impacts divorce and there is the bankruptcy case that was cited by one of the Amici that are filed in this case, *Stanley v. Reef Securities*. There's that the Dallas Court of Appeals and the Dallas Court of Appeals made clear that partnership income held by the partnership is not subject to being accessed by a creditor.

CHIEF JUSTICE WALLACE B. JEFFERSON: Do you agree that HB3 was intended to find an additional revenue source for public school financing?

ATTORNEY DANICA MILIOS: Yes, I do.

CHIEF JUSTICE WALLACE B. JEFFERSON: And can you quantify if the State were not able to tax partnerships, what impact that would have on that intention?

ATTORNEY DANICA MILIOS: Well, it would certainly bring down the revenue that the State could have to go to the school system.

CHIEF JUSTICE WALLACE B. JEFFERSON: Do you have any sense of the numbers at all?

ATTORNEY DANICA MILIOS: I haven't. I haven't been able to get that information. I don't know that we, I don't know that information is gettable. It's certainly the case that it's not the overwhelming majority of the revenues brought in by the State, but it is a sizable chunk and in an era when every penny counts, I would submit

that taking the State's ability to tax partnerships away would obviously send the legislature back into a special session.

JUSTICE PHIL JOHNSON: Or say they're not asking to tax partnerships. They're modified their position now to where they only are seeking relief for natural persons.

ATTORNEY DANICA MILIOS: That's true. That is absolutely true.

JUSTICE PHIL JOHNSON: And their portion.

ATTORNEY DANICA MILIOS: That's right. And so that does reduce, obviously, the impact that it would have, but it still sets up the notion that the Texas legislature is without the authority to treat partnerships at separate business entities for all purposes and the most important one to the state being taxation purposes all without that statement ever having been made by the Texas legislature, the body who is ultimately responsible for defining how business entities are viewed in Texas, how they're taxed in Texas and how property interests are treated in Texas.

JUSTICE DON R. WILLETT: What points do you want to make today on jurisdiction?

ATTORNEY DANICA MILIOS: The State is happy to answer any questions the Court has. We are not taking a position on whether the Court should exercise jurisdiction. The Court has spoken on this issue. The Court has looked to the legislature's authority to confer original jurisdiction on this Court in *Love v. Wilcox* and the court unequivocally held that the legislature is without authority to confer original jurisdiction on this Court other than the power to issue writs, quo warranto and mandamus.

JUSTICE DEBRA H. LEHRMANN: Do you think that this action could be construed as a mandamus?

ATTORNEY DANICA MILIOS: I absolutely do not. This is not a mandamus. This is a garden variety challenge to the constitutionality of the statute. Mandamus exists to compel administrative duty or to stop an abuse of discretion.

JUSTICE DEBRA H. LEHRMANN: Well, what about the argument that this is actually an action for a mandamus to be issued to stop the comptroller from enforcing this?

ATTORNEY DANICA MILIOS: Right, it can never, that would be characterized as an abuse of discretion, Your Honor. Right. It can never be an abuse of discretion for a state official to enforce a statute that has been duly enacted by the legislature and never held by this Court to be unconstitutional. Now the court-

JUSTICE PHIL JOHNSON: But we have said, it's an abuse of discretion to violate the law whether there's interpretation or not. So if it's determined to be unconstitutional, that would warrant mandamus, would it not?

ATTORNEY DANICA MILIOS: It would not.

JUSTICE PHIL JOHNSON: If it's determined in this case. If we determine this is an unconstitutional statute, you're saying we have no authority to issue mandamus?

ATTORNEY DANICA MILIOS: The Court has the authority to reconstrue its mandamus power, I would agree with that. If the Court were to decide in this case that a garden variety challenge to the constitutionality of a statute could be viewed as a mandamus, then the Court could rewrite its mandamus law and say from here, going forward, anyone who wants to challenge the constitutionality of a statute can bring it here in this Court as an original matter as long as you're suing one of the individual state officials listed in the Texas constitution.

JUSTICE PHIL JOHNSON: What's your position on the opposing party's statement that after those cases, we issued those cases, then the constituent was amended to give general jurisdiction except as drawn out of it by the other portions of the constitution?

ATTORNEY DANICA MILIOS: The problem with that argument is it's either two or threefold. In the first place, that statement is stealthy. The first sentence of the Court's power now in Article 5, Section 3, still says, except as otherwise provided by this constitution. And you don't have to go very far in this section of the finding of the Court's jurisdiction to find the same sentence that was in this provision back in 1930 when the court decided *Love v. Wilcox*, limiting the legislature's authority to confer upon this Court original jurisdiction to issue writs other than mandamus and quo warranto. And this Court has reviewed the first sentence of Article 5, Section 3, in *State v. Gomez* and in *Chenault v. Phillips*, the Court talked about its inherent power. The commentators, particularly Judge Greenhill, referred to the exercise, the judicial power of the state, that phrase from the first sentence of the Court's section, that refers to the Court's inherent power and in *State v. Gomez* and in *Chenault v. Phillips*, the court explained that's talking about administrative power. That allows the Court to regulate lawyers, to create rules for the bar.

JUSTICE DON R. WILLET: Rewinding a few minutes, did you say a few minutes ago that you thought a state official, unless and until a court had declared a statute unconstitutional would have no latitude through refuse to enforce that or carry out that statute?

ATTORNEY DANICA MILIOS: No, that is exactly the circumstance where the constitutionality of the statute may come into effect as a shield against mandamus and the case that Plaintiffs cite for the principle that the constitutionality of a statute is available to bring a mandamus says, exactly the opposite. The case is *Corsicana Cotton Mills v. Sheppard*. In that case, the plaintiffs brought a mandamus to compel the state official to comply with the law and the state official said, I'm not going to comply with that law because it's unconstitutional. So the state official used the unalleged unconstitutionality of the statute as a shield to mandamus not as a sword to bring a mandamus and in that case, the court denied the mandamus. So no, in its discussion in *Corsicana Cotton Mills*, the court made clear that it was talking about in the official's discretion. If the official believes that the statute is unconstitutional, then the official has the latitude, Justice Willet, to stand on his beliefs that the statute is unconstitutional and defend against the upcoming mandamus on that basis. But we have to distinguish, Justice Johnson, getting back to your question, between provisions that are directed toward state officials to actually do something, like the provision in the constitution that requires the comptroller to certify the budget coming into the legislative session. That's a constitutional provision that is directed at the comptroller. If she refuses to do it, that's probably a mandamusable event. But the Bullock Amendment is not directed at the comptroller. It's not directed at the attorney general. It's directed at the legislature. So if the separation of powers is to mean anything, it is that when the legislature enacts a statute that it believes to be constitutional, that the state officials who are charged with enforcing it must also enforce it to the extent they believe it is constitutional unless and until this Court tells them that they can't.

JUSTICE PAUL W. GREEN: Let me go back to something that Justice Hecht was alluding to about the entities. There's a lot of associations or groups out there that are loosely organized partnerships, maybe you could argue that they're really not a partnership, maybe they are, if there's some legal challenge as to whether or not you could define it as a partnership, but how does the State treat those? Are there differences in the way the State would treat for tax purposes something that is a formal partnership versus one that maybe actually is a partnership, but is not formally defined as one.

ATTORNEY DANICA MILIOS: Well, under the Business Organizations Code, there are requirements that a group has to go through to become a partnership and they have to follow the Secretary of State. So that would be the triggering event. If --

JUSTICE PAUL W. GREEN: But you -- okay. Only those that are, that process has been done.

ATTORNEY DANICA MILIOS: That's correct. And I would like --

JUSTICE PAUL W. GREEN: And that leaves out a lot of people, a lot of partnerships out there perhaps have not gone through that formal process.

ATTORNEY DANICA MILIOS: And you're probably talking about partnerships that are made of all natural persons. Those folks are not taxed by the franchise tax so if you have a general partnership, for example, that is made up of totally natural persons, no franchise tax. So those folks are not an issue. They're not a problem. Sole proprietorships, not a problem. Unincorporated associations who have no filing with the state, no recognized status with the state, not a problem, not taxed by the franchise tax.

JUSTICE PAUL W. GREEN: But if Paul Green Incorporated associated with somebody that would trigger the tax entity?

ATTORNEY DANICA MILIOS: If you are incorporated, yes. But then you're not a partnership anymore so you don't have the partnership-

JUSTICE PAUL W. GREEN: I mean a corporation as a partner with someone else.

ATTORNEY DANICA MILIOS: Yes, that is correct. If --

JUSTICE PHIL JOHNSON: They say in this case they have non-natural persons as limited partners.

ATTORNEY DANICA MILIOS: That's correct.

JUSTICE PHIL JOHNSON: So your position would be or their position would be that you could tax everyone except the natural person?

ATTORNEY DANICA MILIOS: That's correct.

JUSTICE PHIL JOHNSON: And is that and under your construction, that would be incorrect. You would have to tax the whole partnership even though some of them were natural persons if some of them were corporations. If some of the limited partners, corporations, the entire partnership, limited partnership is taxable?

ATTORNEY DANICA MILIOS: Yes, that is correct. The franchise tax taxes, if you qualify as a taxable entity under the franchise tax, then you're taxed. What Plaintiffs I think are seeking is for the Court to fashion its remedy in this case to only strike down the franchise tax if the Court rules in Plaintiff's favor as it's applied to natural persons so that Mr. Weakley would no longer be required to pay the franchise tax, but Allcat would still be required to pay the franchise tax.

JUSTICE PHIL JOHNSON: So Allcat would not pay his part of the franchise tax when they sent it in.

ATTORNEY DANICA MILIOS: That is certainly-

JUSTICE PHIL JOHNSON: I guess mechanically.

ATTORNEY DANICA MILIOS: Right, that is the relief that the Plaintiffs are seeking. Well, if there are no questions, then I will yield the rest of my time.

CHIEF JUSTICE WALLACE B. JEFFERSON: No further questions, thank you Counselor. The Court will hear rebuttal.

REBUTTAL ARGUMENT OF JAMES F. MARTENS ON BEHALF OF PETITIONER

ATTORNEY JAMES F. MARTENS: Thank you, Your Honor. I don't know if you caught this, but every time we were talking about the entity theory, the business entity theory, the authorities relied upon by opposing Counsel dealt with property. They dealt with cash to be distributed. Divorce cases deal with property. They don't deal with-

JUSTICE PHIL JOHNSON: So [inaudible] -- When someone sends a check to Allcat because they adjusted the claim, what is it when you get the check or the electronic transfer or funds or whatever, whenever that money comes in?

ATTORNEY JAMES F. MARTENS: The item that comes in is an asset. It is a piece of property, but that is different than-

JUSTICE PHIL JOHNSON: It is property?

ATTORNEY JAMES F. MARTENS: Yes, yes. A check is property, but profits-

JUSTICE PHIL JOHNSON: So is money, right?

ATTORNEY JAMES F. MARTENS: Money is property.

JUSTICE PHIL JOHNSON: You agree that money is property?

ATTORNEY JAMES F. MARTENS: That is correct, but as business goes on and revenues are generated and expenses are incurred, those happen with checks, but that concept itself, that income concept itself is fundamentally different and it is the idea that partners own their proportionate shares of income. They get credited to the capital accounts, which were referenced not in Redsmith, but opposing Counsel stated what they, she talked about their capital accounts. It is the individual accounts of the partners inside the books of a partnership that correspond to their proportionate shares that make a partnership a partnership. If you ignore that rule, if you write 152.202(a) out of our code, which is what you would have to do to follow their position, then partnerships are no longer partnerships because that's what distinguishes a partnership from all other entity form. The flow of income, it's an ongoing concept. It's a measurement of activity over a point in time about an income statement for a year. Property, the measurement of property is something that happens as a snapshot at a particular point in time. Property, if you conflate income with cash distributions, you wind up with a tax structure that nobody has ever had that is the a taxation on the distribution itself and you couldn't do that because you don't know where that cash necessarily comes from. I want to read to you from what Bob Bullock and the others were looking at when they were considering the Bob Bullock Amendment. This is the Nevada Constitution. It says, no income tax shall be levied on the wages or personal income of natural persons notwithstanding the foregoing provision and except as otherwise provided in Section 1. Taxes may be levied upon the income or revenue of any business in whatever form it may be conducted for profit in the state. They read that. They were given demos on that and they rejected that and the reason that they rejected that was true to Bob Bullock's statement and he meant it when he said, a tax on partnership income is really a tax on personal income and he makes that clear and to adopt-

JUSTICE NATHAN L. HECHT: But if he were wrong about that as a matter of law, if he were, then where does that leave us?

ATTORNEY JAMES F. MARTENS: That leaves us exactly right where we are with the plain text of the Bullock Amendment and it leaves us with looking at its plain language not judicially rewriting it. If you go with the business entities argument, then sole proprietorships are subject to tax and by the way, limited partnerships owned 100% by natural persons are subject to tax. Limited liability partnerships, which are general partnerships

over Texas law owned 100% by natural person partners are subject to this tax. So all forms of limited partnerships are subject to this tax except for general partnerships whose owners are only and directly natural persons. I wanted to make the point also-

JUSTICE PHIL JOHNSON: In the Bullock Amendment, it talks about the net incomes of natural persons.

ATTORNEY JAMES F. MARTENS: Yes.

JUSTICE PHIL JOHNSON: Including a person's share of partnership. Does the term, net reference the natural person income as well as the share of partnership and unincorporated association with them?

ATTORNEY JAMES F. MARTENS: Yes. You may have--

JUSTICE PHIL JOHNSON: We're talking about net, not gross or not revenue.

ATTORNEY JAMES F. MARTENS: Right, right.

JUSTICE PHIL JOHNSON: We're talking in all instances about revenue less expenses of business and then we're talking net incomes across the board in your view.

ATTORNEY JAMES F. MARTENS: No, well, we're not because net income would include what an individual, if I'm an individual wage-earner and all I have is a W2 coming in, a net income tax is imposed upon me on my gross wages, okay. Now when we talk about in a partnership context, we look at revenues coming in minus one or more deductions. It doesn't matter how many and what they are just so long as it's net because if you adopt a definition that requires all of the economic deductions that would otherwise occur, we could easily do an end run around the Bullock Amendment just by backing up our deductions so that we can say it's not an income tax and we can then impose it on legal entities. The-

JUSTICE DEBRA H. LEHRMANN: Can I ask you something?

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE DEBRA H. LEHRMANN: The Chief I think asked earlier a little bit about the legislature intended to create, I think we all agree, a constitutional method of raising revenue for the public schools.

ATTORNEY JAMES F. MARTENS: Yes, Your Honor.

JUSTICE DEBRA H. LEHRMANN: What is the impact going to be if you're correct?

ATTORNEY JAMES F. MARTENS: Your Honor, the impact, well I guess depend upon the relief the Court affords. If they provide relief for a natural person, if they provide a relief that is specifically tied to the constitutional violation which is the tax imposed on a natural person's partner share of partnership income, I don't know what the relief is, but I know that it's going to be less than the full amount of partnerships because we can tax a corporate partner's share of partnership income. If the Court decides as it did in the Carrolton ISD case to grant prospective relief only and say we're not going to go backwards in time. This case meets the elements of Carrolton ISD, so we're going to not let it get enforced until we have either a vote on this tax or a tax implemented that doesn't violate the plain text of this amendment, then, the consequences are less significant. But I would say this in my last moment. If you read the text of the Bullock Amendment and 152.202(a) and Article 8, Section 1C and if you put them altogether with the legislative history with those statements that were made prior to the adoption of the Bullock Amendment, you come to the inescapable conclusion that all of this means exactly what Bob Bullock said, which is a tax on partnership income is really a tax on personal income. The separate legal entity theory for partnerships does not apply to income. It cannot because they wouldn't be partnerships if you

did it that way.

JUSTICE DON R. WILLETT: And for those of us who are less enamored of isolated snippets in the legislative record, what do you most rely on?

ATTORNEY JAMES F. MARTENS: For the legislative history?

JUSTICE DON R. WILLETT: Yes.

ATTORNEY JAMES F. MARTENS: Well, we have a pledge letter signed by Bob Bullock.

JUSTICE DON R. WILLETT: Right, but for those of us who aren't quite as fond of snippets drawn from the record.

ATTORNEY JAMES F. MARTENS: In the way of legislative issues?

JUSTICE DON R. WILLETT: You would just rely on the text of the statute itself.

ATTORNEY JAMES F. MARTENS: Well, the text of the statute does it, but you have the failed Hury Amendment, the substitution of increased occupation taxes on individuals, on the professionals in its stead, the payment of those in '92 and '93 and then voting the amendment by those folks with those laws fresh on their minds not wanting to have an income tax they've already been taxed through the occupations code.

CHIEF JUSTICE WALLACE B. JEFFERSON: There are no further questions. Thank you, Mr. Martens.

ATTORNEY JAMES F. MARTENS: Thank you.

CHIEF JUSTICE WALLACE B. JEFFERSON: And Counsel, the cause is submitted and the clerk will now adjourn the Court.

MARSHAL: All rise.

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