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NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

THE LIMITED STORES, INC., et al.,	
Plaintiffs and Appellants,	**A102915**
v.	
FRANCHISE TAX BOARD,	**(Alameda County**
Defendant and Respondent.	**Super. Ct. No. 837723-0)**

Plaintiffs, The Limited Stores, Inc., and 24 of its affiliated corporations (hereafter collectively The Limited), compose a unitary business,[1] that retails within and without California and, so, is subject to California taxes on its California source income. (Rev. & Tax. Code,[2] § 25101.) The Uniform Division of Income for Tax Purposes Act (UDITPA) (§ 25120 et seq.) utilizes an apportionment formula to determine the taxes California may appropriately levy on such a business. This formula includes a "property

[1] A group of corporations, linked by more than a 50 percent common ownership as set forth in Revenue and Taxation Code section 25105, are engaged in a unitary business if they share other connections commonly described as "unity of operation" and "unity of use" or as "contribution and dependency." (See *Dental Insurance Consultants, Inc. v. Franchise Tax Bd.* (1991) 1 Cal.App.4th 343, 347-348.)

[2] All undesignated section references are to the Revenue and Taxation Code.

factor," a "payroll factor," and a "sales factor." (§ 25128.) Section 25134[3] provides that the sales factor is a fraction comprised of the taxpayer's total sales in California divided by the taxpayer's total sales everywhere. Section 25120, subdivision (e)[4] defines the term "sales" to mean "all gross receipts of the taxpayer" not allocated as nonbusiness income. The term "gross receipts" is itself not defined in the UDITPA.

The present controversy focuses on The Limited's investment of its excess cash on hand in short-term financial instruments. In assessing the sales factor in the apportionment formula, the Franchise Tax Board (FTB) excluded the returns of principal invested on a daily basis by The Limited in short-term financial instruments, such as United States Treasury Bills, which The Limited held to maturity. The Limited contends that the return of principal from these regular activities of its treasury department must be included in its "*gross* receipts" for purposes of the apportionment formula prescribed by the UDIPTA. The FTB disagrees, and separately argues that even if the returns of principal from such investments qualify as "gross receipts," the FTB may properly use an alternative apportionment method to tax the proceeds under a distinct UDITPA provision applicable when the "apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state." (§ 25137.) The trial court concluded that the returns of principal from debt instruments held to maturity are not "sales" within the meaning of the pertinent UDITPA provisions and, therefore, are not includable in the apportionment formula that defines "sales" as including "all gross receipts." We agree and affirm the summary judgment granted in favor of the FTB.

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[3] Section 25134 provides: "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year."

[4] Section 25120, subdivision (e) provides: " 'Sales' means all gross receipts of the taxpayer not allocated under Sections 25123 through 25127 of this code."

BACKGROUND

The Limited is a retailer of men's and women's clothing and bath products, incorporated in Delaware, with its headquarters and principal place of business located in Columbus, Ohio. The Limited's treasury department is located at the Ohio headquarters and conducts all of the retailer's investment activities there. Three employees within the treasury department manage the cash receipts of The Limited's business activities by investing excess cash flow on a daily basis in short-term financial instruments such as commercial paper, certificates of deposit, United States Treasury Bills, money market mutual funds, and offshore investments. For each such investment during the relevant period, The Limited received its own money back (return of principal), plus income in the form of either interest or dividends, and then reinvested those funds in similar interest or dividend bearing instruments.[5] At least 60 percent of the total proceeds from these investments during the years at issue were derived from financial instruments held for only one day.[6] Over 95 percent of the short-term financial instruments in which The Limited invested during the years in issue were held to maturity and redeemed.

The Limited included all money received when these investments matured, including the returns of principal, in its calculation of the sales factor because it contends this money constitutes "gross receipts," as that term is used in section 25120, subdivision (e). Using The Limited's methodology, the gross receipts derived from short-term financial instruments added into the sales factor were $12 billion for fiscal year 1993, and $8.3 billion for fiscal year 1994. In contrast, under the FTB's methodology (incorporating only income), the gross receipts derived from short-term financial

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[5] For purchases of money market mutual funds, the income was received as dividends; for purchases of the remaining investments, the income was received as interest.

[6] During The Limited's fiscal year ending January 31, 1993, 67 percent of the total proceeds derived from financial instruments held for one day and 8.5 percent of the proceeds derived from financial instruments held for 30 days or more. During fiscal year ending January 31, 1994, 60 percent of the total proceeds derived from short-term financial instruments held for one day and 12 percent derived from financial instruments held 30 days or more.

instruments added into in the sales factor was $8.3 million for 1993, and $7.6 million for 1994.

Under The Limited's methodology, the gross receipts comprising the denominator of the sales factor totaled $19.3 billion for 1993 and $16.1 billion for 1994. In contrast, under the FTB's methodology, the gross receipts totaled $7.3 billion for 1993 and $7.7 billion for 1994. The Limited's methodology decreased the overall taxation apportionment percentage for California by 21 percent in 1993 (from 8.4208 percent to 6.6508 percent) and by 26 percent in 1994 (from 8.9726 percent to 6.6366 percent).

The Limited filed combined unitary returns for 1993 and 1994 using its methodology. After the FTB disputed this action, The Limited exhausted its administrative remedies and filed this action seeking refund of $5.6 million in corporate franchise taxes. In due course, the parties filed cross-motions for summary judgment on the first and second causes of action based on the undisputed material facts summarized above.[7]

In the briefing for the FTB's summary judgment motion (and reasserted here), the FTB has acknowledged that gross receipts derived from the *sale* of financial instruments occurring *prior to* their maturity are properly included in the sales factor. Conversely, the FTB asserts that the return of principal from financial instruments *held to maturity* may not be included in the sales factor.

On April 11, 2003, the trial court granted the FTB's motion, concurring with the FTB's interpretation of the term "gross receipts" under sections 25120 and 25134. The trial court acknowledged that The Limited's interpretation was consistent with "a literal reading of section 25134 . . . in conjunction with [section 25120, subdivision (e)]." However, the court reasoned that the meaning of the term "gross receipts" must be interpreted in light of the fact that section 25134 was intended to define *sales*. "The purpose of the sales factor is . . . to reflect the market for goods and services, and there is no market exploited by the return of principal from short-term financial instruments."

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[7] The remaining causes of action were settled by the parties.

The court determined that The Limited's interpretation would be inconsistent with the purpose of the provision and would lead to absurd results. Among other consequences, The Limited's construction "could allow manipulation of the sales factor, by corporations simply varying the amount, or frequency, of their short-term investments." In light of the court's interpretation of "gross receipts," it did not reach the FTB's alternative argument, based on section 25137, that the latter section permits the FTB to use a different method to apportion the revenues of a unitary business when the UDITPA apportionment provisions do not "fairly represent the extent of the taxpayer's business activity in this state." (§ 25137.)

DISCUSSION

I. *Standard of Review*

We review summary judgment rulings de novo to determine whether the moving party has met its burden of persuasion that there is no triable issue as to any material fact and that the moving party is entitled to judgment as a matter of law. (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 850; Code Civ. Proc., § 437c, subds. (c) & (*o*)(2).) Likewise, we apply the de novo standard of review when, as here, the material facts are undisputed and we must determine whether the trial court properly construed the underlying statutory provisions and applied them to the undisputed facts. (*Regents of University of California v. Superior Court* (1999) 20 Cal.4th 509, 531; *Rosse v. DeSoto Cab Co.* (1995) 34 Cal.App.4th 1047, 1050.) We are not bound by the trial court's stated reasons in support of its ruling; we review the ruling, not its rationale. (*Stratton v. First Nat. Life Ins. Co.* (1989) 210 Cal.App.3d 1071, 1083.)

II. *Is Return of Principal from Debt Instruments Held to Maturity a "Gross Receipt" Under UDITPA*?

The Limited contends that a literal reading of sections 25120, subdivision (e) and 25134 clearly provides for the inclusion of the return of principal from the short-term financial instruments at issue here, and that where the language of a statute is plain, the sole function of the courts is to enforce it according to its terms. (*Leroy T. v. Workmen's*

Comp. Appeals Bd. (1974) 12 Cal.3d 434, 438.) Relying upon the "plain meaning" rule and directing our attention to dictionary definitions[8] of the terms "gross" and "receipt," The Limited asserts that all money received from its investment in financial instruments constitute "gross receipts" of the investments, including the return of The Limited's own principal. The Limited further argues that any perceived uncertainty in the provision must be interpreted in its favor given the customary rule that tax statutes are to be strictly construed against the government. (*County of Los Angeles v. Jones* (1939) 13 Cal.2d 554, 561-562.)

A. *Interpretation of "All Gross Receipts" for Unitary Business Taxation*

In evaluating The Limited's interpretation of these sections, familiar rules of statutory interpretation guide our task. The fundamental purpose of statutory construction is to ascertain the intent of the lawmakers, so as to effectuate the purpose of the law. In determining the intent, we begin by examining the language of the statute. (*Palos Verdes Faculty Assn. v. Palos Verdes Peninsula Unified Sch. Dist.* (1978) 21 Cal.3d 650, 658.) Under the so-called "plain meaning" rule, words used in a statute should be given the meaning they bear in ordinary use. (*Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735.) "If the language is clear and unambiguous there is no need for construction." (*Ibid.*) However, " ' "[I]t is a settled principle of statutory interpretation that language of a statute should not be given a literal meaning if doing so would result in absurd consequences which the Legislature did not intend." ' [Citations.]" (*Younger v. Superior Court* (1978) 21 Cal.3d 102, 113; accord, *Lungren*, at p. 735.) "Ultimately, the court must select the construction that comports most closely with the apparent intent of the Legislature, with a view to promoting rather than defeating the general purpose of the

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8 We are directed to the Black's Law Dictionary definition of the term "gross" as meaning, in relevant part: "Before or without diminution or deduction. Whole; entire; total; as the gross sum, amount, weight—opposed to net." (Blacks's Law Dict. (6th ed. 1990) p. 702, col. 2.) Black's Law Dictionary defines "receipt," in relevant part, as "[t]hat which comes in, in distinction from what is expended, paid out, sent away, and the like." (*Id.* at p. 1268, col. 1.)

statute, and it must avoid an interpretation leading to absurd consequences. [Citation.]" (*In re Luke W*. (2001) 88 Cal.App.4th 650, 655.)

In this instance, we agree with the trial court that the term "gross receipts," must be interpreted in the context of what it is being used to define, i.e., "sales." As the trial court rightly noted, "The purpose of the sales factor is . . . to reflect the consumer state's contributions to the profitability of a multi-state enterprise. Sales are included in the apportionment factor to reflect the market for goods and services, and there is no market exploited by the return of principal from short-term financial instruments." Here, the daily investment of The Limited's "cash position" in short-term financial instruments is more akin to a taxpayer making repeated deposits and withdrawals from an interest bearing bank account, than to anything approximating the sale of a good or service. In essence, The Limited was lending its excess cash for very short periods of time (in most instances for just one day)[9] and receiving its money back, with income in the form of interest or dividends, to be repeated again and again. The recurring reinvestment of cash reserves of the unitary business by its treasury department does not foster a true reflection of its business done "within and without" California, nor the many other states where it operates. Indeed, it is undisputed that this one activity by the three-person treasury department led to a return of principal and interest or dividends that easily dwarfed the total gross receipts of all The Limited's other business activities combined.

A "loan is not a sale in the usual business sense. A sale is an absolute transfer of property or something of value for a consideration from the seller to the buyer. [Citation.] A loan of money, on the other hand, is an advance of money or credit upon an understanding that an equivalent is to be returned to the lender by the borrower on demand or within a specified time. In the United States, money is merely a medium of exchange, not something which is bought and sold in exchange for something else. One does not 'sell' money in the usual business sense." (*United States v. Investors Diversified Services* (D.Minn. 1951) 102 F.Supp. 645, 647.) Since the lender is only exchanging the

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9 See footnote 6, *ante*, page 3.

use of its funds in return for interest or dividend income, the lender's only actual *receipt* from the loan is the income or other consideration derived from the activity, not the return of principal itself. Due to the nature of the transactions, we conclude that the return of principal from the investment of cash in short-term financial instruments held to maturity does not arise out of a sales transaction, and, thus, should not be included as "gross receipts" in the denominator of the sales factor under UDITPA.

Similar conclusions have been reached by courts in other states interpreting equivalent provisions. In *American Tel. & Tel. v. Taxation Div. Director* (1984) 194 N.J.Super. 168 [476 A.2d 800] (*AT&T-New Jersey*), the court upheld the exclusion of gross revenues received by the taxpayer from the "sale or maturity of investment paper."[10] (*Id*. at 802.) The court concurred with the trial court's observation that "idle cash can be turned over repeatedly by investment in short-term securities. It is no true reflection of the scope of AT&T's business done within and without New Jersey to allocate to the numerator or the denominator of the receipts fraction the full amount of money returned to AT&T upon the sale or redemption of investment paper. To include such receipts in the fraction would be comparable to measuring business activity by the amount of money that a taxpayer repeatedly deposited and withdrew from its own bank account. The bulk of funds flowing back to AT&T from investment paper was simply its own money. Whatever other justification there is for excluding such revenues from the receipts fraction, it is sufficient to say that to do otherwise produces an absurd interpretation of [the statute]. 'It is axiomatic that a statute will not be construed to lead

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10 As described by the court in *AT&T-New Jersey*, the New Jersey statute at issue there defined its "receipts" as a fraction made up of "New Jersey related receipts from sales, services, etc." divided by "Total receipts of [the] taxpayer from sales, services, etc." (*AT&T-New Jersey, supra,* 476 A.2d at p. 801 [interpreting N.J.S.A. § 54:10A-6(B)].) The New Jersey formula is functionally identical to the formula used by California to define its sales factor under section 25134. (See fn. 3, *ante*, p. 2.) Because the rationale for the decision in *AT&T-New Jersey* (i.e., rejecting an interpretation of the statute that would otherwise lead to an absurd result) applies with equal force to the interpretation of section 25134 advocated by The Limited, we reject its assertion that the *AT&T-New Jersey* decision is of limited relevance.

to absurd results. All rules of construction are subordinate to that obvious proposition. [Even the rule of strict construction] does not mean that a ridiculous result shall be reached because some ingenious path may be found to that end.' [Citation.]" (*Ibid.*)

In *Sherwin-Williams v. Dept. of State Revenue* (Ind.Tax 1996) 673 N.E.2d 849, the Indiana Tax Court followed the reasoning of the *AT&T-New Jersey* decision in upholding the determination by the Indiana State Department of Revenue that apportionment cannot result from inclusion of "rolled over capital" in a sales factor identical to California's.[11] (*Sherwin-Williams*, at pp. 851-853.) The court concluded that " 'gross receipts' for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities." (*Id.* at p. 853.)

More recently, an Arizona appellate court, relying in part on a Second District Court of Appeal decision that is now before our Supreme Court,[12] also concluded that a taxpayer's "gross receipts" under Arizona's UDIPTA provisions does not include the return of investment principal from the same types of short-term investments at issue here. (*Walgreen Ariz. Drug v. Ariz. Dept. of Rev.* (Ariz.App. 2004) 97 P.3d 896, 897, 899-900, 902.) The court reasoned that the "purpose of the sales factor is to tax an entity for the benefits it receives by exploiting a market *in that state*." (*Id.* at p. 899.) Accordingly, the court perceived no inconsistency in treating the return of principal from short-term investments differently than the proceeds (including investment proceeds) from a business's regular inventory sales. (*Ibid.*) The court concluded that "the 'strict'

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[11] Indiana's "sales factor" and "sales" definitions are identical to California's. (See *Sherwin-Williams v. Dept. of State Revenue, supra,* 673 N.E.2d at p. 851.) "The term 'sales' means all gross receipts of the taxpayer not allocated . . . ." (Ind. Code Ann., § 6-3-1-24.) "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." (Ind. Code Ann., § 6-3-2-(e).)

[12] *General Motors Corp. v. Franchise Tax Bd.* (2004) 120 Cal.App.4th 114, review granted October 13, 2004, S127086.

interpretation approach urged by the Taxpayer would create a tax loophole for non-domiciliary businesses neither intended by the Arizona Legislature nor required by the plain meaning of [Arizona's statutory definition of 'sales'] and the related statutory scheme." (*Id*. at pp. 898, 902.)

The Limited directs us to cases from other states that it contends support its interpretation of the "all gross receipts" language. The cited cases are: (1) *Sherwin-Williams Co. v. Department of Revenue* (Or. 2000) 996 P.2d 500; (2) *AT&T v. Department of Revenue* (Or.Tax 2000) 15 OTR 202 [2000 Ore. Tax LEXIS 17] (*AT&T-Oregon*); (3) *Pennzoil Co. v. Department of Revenue* (Or.Tax 2000) 15 OTR 101 [2000 Ore. Tax LEXIS 6]; (4) *American Tel. & Tel. v. Tax Appeal Bd.* (Mont. 1990) 787 P.2d 754 (*AT&T-Montana*); (5) *Illinois Tool Works, Inc. v. Lindley* (Ohio 1982) 436 N.E.2d 220; and (6) *Western Electric Co. v. Norberg* (1983) R.I. Tax Rptr. (CCH) ¶ 200-145 [1983 RI St. Tax Rep. P 200-145]. Careful review of these cases reveals, however, that none of them addressed the precise issue urged here by the FTB; namely, whether returns of principal from matured short-term financial instruments should be included in the gross receipts from repeated reinvestments of excess cash reserves.[13] Thus, they cannot

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[13] *Sherwin-Williams Co. v. Department of Revenue*, *supra,* 996 P.2d 500, was a *per curiam* opinion of the Oregon Supreme Court that only described the taxpayer's activities in general terms as the "purchase and sale of working capital investment securities." The case did not discuss the differences between sales of securities and holding very short-term financial instruments to maturity for daily reinvestment. (*Id.* at pp. 500-501.) There is no indication that Oregon's Department of Revenue ever raised the argument being raised here by the FTB that the holding of short-term financial instruments to maturity cannot be interpreted as a "sale," and hence should not be treated as such for purposes of the sales factor calculation. *Sherwin-Williams Co.* also noted that in 1995 (years after the end of the taxation period at issue in that case), the Oregon Legislature adopted "ORS 314.665(6)," to provide that "gross receipts arising from the sale, exchange, redemption, or holding of intangible assets shall *not* be treated as 'sales' for purposes of calculating the sales factor of the apportionment formula unless the receipts were derived from the taxpayer's primary business activity." (*Id.* at p. 501, fn. 1, italics added.)

AT&T-Oregon extended the holding of *Sherwin-Williams Co. v. Department of Revenue, supra,* 996 P. 2d 500 to a public utility under a taxing statute specific to utilities. (*AT&T-Oregon, supra,* 2000 Ore. Tax LEXIS, at pp. *2-*4.) In *AT&T-Oregon*,

be construed to stand as support for a proposition they never considered. (*Ginns v. Savage* (1964) 61 Cal.2d 520, 524, fn. 2; *FNB Mortgage Corp. v. Pacific General Group* (1999) 76 Cal.App.4th 1116, 1132.)

B. *Interpretation of "Gross Receipts" in Other Factual Contexts*

The Limited contends that, "[f]or tax purposes, California courts have consistently held that the term 'gross receipts' includes an amount equal to the original investment *and* the amount of gain or other income on such investment." The Limited cites four cases in support of the contention: *Beamer v. Franchise Tax Board* (1977) 19 Cal.3d

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the Oregon Tax Court broadly interpreted "all gross receipts" as "intended to cover almost any profit-oriented activity." (*Id.* at p. *10.) *Pennzoil Co. v. Department of Revenue, supra*, 2000 Ore. Tax LEXIS 6, followed *Sherwin-Williams Co.*, without substantive discussion, to determine that gross proceeds from unspecified financial investment instruments are includible in the denominator of the sales factor. (*Pennzoil Co.*, at p. *28.) Neither the *AT&T-Oregon* nor the *Pennzoil Co.* decision give any indication that Oregon's taxing authority ever argued that holding short-term financial instruments to maturity did not qualify as a "sale" for purposes of the sales factor calculation. (*AT&T-Oregon*, at pp. *9-*11; *Pennzoil Co.*, at pp. *24-*28.)

In *AT&T-Montana, supra,* the Montana Supreme Court upheld a Montana District Court ruling that receipts from temporary cash investments (including commercial paper, United States Treasury instruments, or other "readily liquidated investments") fell within the "all gross receipts" definition of "sales" for purposes of the sales factor. However, at the same time, the Montana Supreme Court upheld the District Court's further ruling to exclude gross receipts from sales of temporary cash investments in the sales factor because it would create distortion. Here again, the decision gives no indication that Montana's taxing authority ever argued the holding of short-term financial instruments to maturity would not qualify as a "sale" for purposes of the sales factor calculation. (787 P.2d at pp. 757-759.)

In *Illinois Tool Works, Inc. v. Lindley, supra,* the Ohio Supreme Court did not reach the Ohio tax commissioner's argument that the taxpayer's sales of treasury bills were not "sales" for purposes of the sales factor because the argument was not timely raised on appeal. (436 N.E.2d at p. 223.)

In *Western Electric Co.v. Norberg, supra,* the Rhode Island District Court held that the taxpayer properly included all receipts from the *sale* of short-term securities in its computation of the apportionment formula. Financial instruments held to maturity were not discussed. (1983 RI St. Tax Rep. P 200-145.)

467; *Gray v. Franchise Tax Board* (1991) 235 Cal.App.3d 36; *Robinson v. Franchise Tax Board* (1981) 120 Cal.App.3d 72; and *MCA, Inc. v. Franchise Tax Board* (1981) 115 Cal.App.3d 185. The Limited acknowledges that these cases did not involve consideration of the definition of "all gross receipts" as used in section 25120, subdivision (e), but asserts that the cases nevertheless confirm that the terms "gross receipts" and "gross income" are not synonymous.

The cases cited by The Limited are unhelpful to its position because they analyzed the difference between gross receipts and gross income in the factual context of sales of property that included or excluded the cost of capital; conversely, they did not involve the return of principal from daily investment of excess cash reserves in short-term financial instruments held to maturity. (*Beamer v. Franchise Tax Board, supra*, 19 Cal.3d at pp. 476-478 [tax from sales of oil and gas computed using the producer's gross receipts, defined to include capital and income]; *Gray v. Franchise Tax Board, supra*, 235 Cal.App.3d at pp. 38, 41-44 [capital gains provisions that tax net capital gains from sales of interests in real estate partnerships after deduction for capital losses is a "net income tax"]; *Robinson v. Franchise Tax Board, supra*, 120 Cal.App.3d at p. 82 [income derived from rents or interest that exclude a return of capital or cost of goods sold are "gross income," not "gross receipts"]; *MCA, Inc. v. Franchise Tax Bd., supra*, 115 Cal.App.3d at pp. 187, 198 [licensure fees paid for "film rentals" and "record royalties" that do not include a cost of goods are "gross income," not "gross receipts"].) Here, the FTB agrees that "gross receipts" would include the return of capital in a factual context where the taxpayer establishes that product revenues involved an actual cost of goods. However, where, as here, the taxpayer's transactions involved no cost of goods, the distinction between gross receipts and gross income from the transactions has no practical import. Indeed, to the extent that *Robinson* and *MCA, Inc.* determine that transactions not involving a cost of goods should be excluded from "gross receipts," those cases are consistent with the FTB's interpretation of gross receipts.

C. *FTB Regulations Interpreting and Implementing "All Gross Receipts"*

The Limited contends that interpreting "gross receipts" in section 25120, subdivision (e), as requiring an actual "sale" is inconsistent with California Code of Regulations, title 18, section 25134, subdivision (a)(1) (hereafter, generally, Regulation 25134), which provides, in part: "[F]or the purposes of the sales factor . . . , the term 'sales' means all gross receipts derived by the taxpayer from transactions and activity in the regular course of such trade or business." We disagree and treat the contention as a restatement of The Limited's first argument regarding the "plain meaning" of section 25120, subdivision (e) itself. Moreover, after reviewing the "rules" prescribed in Regulation 25134 for determining "sales" in various situations, we conclude they are consonant with the FTB's interpretation of "gross receipts." Specifically, the rule set forth in Regulation 25134, subdivision (a)(1)(A) provides that in the case of businesses, like The Limited, which are engaged in manufacturing and selling or purchasing and reselling goods or products, the term " 'sales' includes all gross receipts from the sales of such goods or products . . . primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales, *less returns and allowances and includes all interest income*, service charges, carrying charges, or time-price differential charges incidental to such sales." (Ialics added.) Under this rule the taxpayer is directed to exclude from "gross receipts" any amounts for *items returned* from a customer, but is directed to include any *interest* or other income derived from such sales. The Limited has articulated no reason why the "return" of the principal it invested in the short-term financial instrument and held to maturity, day after day, should be treated any differently.

Another rule, Regulation 25134, subdivision (a)(1)(D), provides that "[i]n the case of a taxpayer engaged in renting real or tangible property, [the term] 'sales' includes the gross receipts from the rental, lease or licensing the use of the property." The taxpayer does not include the actual value of the property being rented to the customer within sales factor "gross receipts," except in the event that the property used for the rental is sold by

the business. (See Reg. 25134, subd. (a)(1)(F).) In our view, the rental business situation is analogous to the "cash management activities" of The Limited's treasury department, which, in effect, was engaged in the short-term "rental" of The Limited's excess cash in exchange for interest or dividend income. No justification has been presented for treating the return of investment principal any differently for purposes of computing "gross receipts" than the return of an item of rental property once each respective use has come to an end.[14]

D. *State Board of Equalization Decisions Involving the "Sales Factor"*

The Limited asserts that California State Board of Equalization (SBE) decisions confirm The Limited's interpretation of "gross receipts," citing *Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc.* (June 2, 1989) Cal. Tax Rptr. (CCH) paragraph 401-740, page 25,549 [1989 Cal. St. Tax Rep. (CCH) P 401-740] (*Merrill, Lynch*) and *Appeals of Pacific Telephone & Telegraph Co.* (May 4, 1978) Cal.Tax Rptr. (CCH) paragraph 205-858, page 14,907-36 [1978 Cal. St. Tax Rep. (CCH) P 205-858] (*Pacific Telephone*).

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14 The Limited asserts that the drafters of the model UDITPA (later adopted by California) had rejected the FTB's position on the issue presented in this appeal. To support this assertion, The Limited requested that we take judicial notice of excerpts from transcripts of proceedings held in 1956 and 1957 by the Committee of the Whole for the UDITPA that indicate the proposed definition of "sales" was changed during the drafting process from reading (in 1956) " 'Sales' means all *income* of the taxpayer . . ." to reading (in 1957) " 'Sales' means all *gross receipts* of the taxpayer . . . ." The Limited argues this wording change indicates the drafters of the UDITPA favored a broader interpretation of "sales" that would include all amounts received, whether or not such amounts constitute income. Notably, however, the FTB has never contended that the definition of "sales" in section 25120, subdivision (e) is limited only to "income" of a taxpayer. The proffered excerpts from the model UDITPA proceedings did not address, and, hence, are inapposite to the question of whether "gross receipts" was intended to encompass the return of principal from short-term debt instruments held to maturity. Accordingly, we deny The Limited's November 2003 request for judicial notice of these excerpts because we find they are not relevant to issue before us. (See *Schifando v. City of Los Angeles* (2003) 31 Cal.4th 1074, 1089, fn. 4.) We also deny the FTB's May 2004 request for judicial notice of its research of state laws from the other 49 states regarding the tax treatment of short-term investment activities for tax apportionment purposes.

Again, we disagree. A review of these cases reveals that they did not analyze the definition of "gross receipts," much less decide whether that term should include returns of principal derived from the daily reinvestment of excess cash in short-term financial instruments held to maturity. Instead, those cases were decided based upon an analysis of whether the particular circumstances in those cases warranted application of an alternative apportionment method under section 25137. (*Merrill, Lynch, supra* [purchases by the brokerage's securities broker of securities for its own account and for remarket from its New York office did not sufficiently distort the sales factor to justify application of section 25137 trigger]; *Pacific Telephone, supra* [without deciding whether returns of principal from the sale or redemption of debt securities should be considered "sales" for purposes of the sales factor, SBE determined that applying an alternative apportionment was justified under section 25137 because inclusion of capital element of receipts from sale or redemption of debt securities substantially overloaded the sales factor in favor of New York and inadequately reflected contributions made by the other states supplying markets for Pacific Telephone's services].) Thus, these cases cannot be construed to stand for a proposition they did not consider. (*Ginns v. Savage, supra*, 61 Cal.2d at p. 524, fn. 2; *FNB Mortgage Corp. v. Pacific General Group, supra*, 76 Cal.App.4th at p. 1132.)

Next, The Limited requests that we take judicial notice of a proposed 1998 amendment to Regulation 25137 and to a discussion of that proposed amendment during an SBE hearing on August 6, 1998. The proposed amendment was directed at gains and losses on the *sale* of liquid assets held in connection with a taxpayer's treasury functions. It is undisputed by the parties that under existing application of the unitary taxation method by the FTB, the entire gross receipts from the sale of business assets (including return of principal) must be included in the sales factor. The FTB sought the proposed amendment to Regulation 25317 based on its assessment that the inclusion of gross receipts from the sale of short-term investments and reinvestments of certain liquid assets resulted in a distortion of the apportionment of a taxpayer's business income. The proposed amendment would have prescribed that only the net overall gain would be

included in the sales factor, without requiring the FTB to establish that inclusion of such gross receipts in the usual apportionment formula distorted the extent of the taxpayer's business activity in the state.

The proposed amendment to Regulation 25137 was opposed on multiple grounds, including that it conflicted with the section 25137 provision limiting modification of the standard apportionment formula to only those instances when the FTB could show that the distortion threshold requirement had been overcome. It was also opposed on the ground that it would conflict with the requirement of section 25120, subdivision (e) that all receipts derived from treasury activities in selling liquid assets be included in the sales factor calculation.

The Limited contends that a statement at the SBE hearing on the matter by an FTB attorney "conceded that the controlling statutes cannot be read as requiring the inclusion of net receipts in the case of short-term financial instruments." The FTB attorney, had stated his belief that the proposed amendment to Regulation 25137 "very clearly is inconsistent with the definition of gross receipts in . . . the statute, and I think that another alternative would be to proceed through a legislative change here."

The trial court denied The Limited's request to judicially notice this evidence in the proceedings below. We likewise deny the request because the statement of opinion by the FTB attorney is not relevant to our determination of whether the return of principal from financial instruments held to maturity can be included in the sales factor. (See *Schifando v. City of Los Angeles, supra*, 31 Cal.4th at p. 1089, fn. 4.) The proposed amendment to Regulation 25137 was directed to *sales* of liquid assets *prior to their maturity*, which is not contested in the present appeal. In fact, the FTB agrees that, under existing law, actual *sales* of short-term financial instruments to third parties prior to maturity are properly included with the sales factor computation under present law. The statement by the FTB attorney at the SBE hearing was in accord with the FTB's position that such *sales* of short-term financial instruments prior to maturity fall within the definition of gross receipts under sections 25120, subdivision (e) and 25134.

III. *Conclusion*

We conclude that the returns of principal to The Limited from debt instruments held to maturity are not "sales" within the meaning of sections 25120, subdivision (e) and 25134, and are, therefore, not includable in the sales factor as part of "all gross receipts." In light of this conclusion, we need not reach the FTB's alternative ground supporting summary judgment based on the proposed application of section 25137.

DISPOSITION

The judgment is affirmed. The FTB is awarded its costs on appeal.

SIMONS, J.

We concur.

JONES, P.J.

GEMELLO, J.