

THE GENETELLI CONSULTING GROUP
State and Local Tax Services
431 FIFTH AVENUE
NEW YORK, NY 10016

(212) 684-4111
FACSIMILE: (212) 213-1020
EMAIL: rgenetelli@genetelli.com

Subject: Toys "R" Us, Inc. v. Franchise Tax Board
Date: May 4, 2006

To: Our Clients and Friends

The issue of whether gross or net proceeds from securities/investment transactions are includible in the receipts factor for apportionment purposes continues to take center stage in California. By way of background, taxpayers in various businesses commonly invest excess cash in short-term financial instruments such as United States Treasury obligations and commercial paper issued by corporations. The income generated by the investments generally constitutes business income, and the transactions giving rise to such income are reflected in the receipts factor.

When the excess cash investments are frequent and/or the size of the investments is large, the impact on the receipts factor can be significant (even when the aggregate net profit is small). The impact often turns on whether the receipts factor should include the gross receipts, or only the net gain, from the sale of the excess cash investments (or whether the receipts should be thrown out of the factor entirely).

In *Toys "R" Us, Inc. v. Franchise Tax Board*, No. C045386 (Cal. Ct. of App. Apr. 5, 2006), the taxpayer was unable to include the total amounts received from the disposition of its short-term paper (i.e., both principal and interest earned thereon) in the receipts factor of the apportionment formula. Only the interest earned on such investment cash was includible in the receipts factor.

Although the court acknowledged that the term "gross receipts" as used in the relevant statute was intended to include total receipts, the court allowed California to use an alternative apportionment method and exclude the taxpayer's return of principal from the receipts factor to fairly reflect business activity in the state. Interestingly, the court ruled that the taxpayer had the burden of proving that California's use of an alternative apportionment method was not reasonable.

As always, taxpayers should review their return filing positions in the various states with respect to the gross versus net issue in light of the applicable statutes, regulations and case law in each state. If you have any questions regarding the within, or any other state and local tax matters, please do not hesitate to contact me.

THE GENETELLI CONSULTING GROUP
State and Local Tax Services

Richard W. Genetelli
The Genetelli Consulting Group
State and Local Tax Consultants
431 Fifth Avenue, 3rd Floor
New York, NY 10016
Tel: (212) 684-4111
Fax: (212) 213-1020
Website: www.genetelli.com