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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

GENERAL MOTORS CORPORATION et al., Plaintiffs and Appellants, v. FRANCHISE TAX BOARD, Defendant and Appellant.	B165665 (Los Angeles County Super. Ct. No. BC269404)

APPEAL from a judgment of the Superior Court of Los Angeles County. Mary Ann Murphy, Judge. Affirmed.

Ajalat, Polley & Ayoob, Charles R. Ajalat, Christopher J. Matarese for Plaintiffs and Appellants.

Bill Lockyer, Attorney General, W. Dean Freeman, Lead Supervising Deputy Attorney General, Stephen Lew, Deputy Attorney General, for Defendant and Appellant.

In this action for a refund of taxes, General Motors Corporation and its affiliated corporations appeal from the superior court's judgment. The California Franchise Tax Board also appeals. We affirm the trial court's judgment. We conclude that, in calculating the amount of income apportionable to California, the Franchise Tax Board properly excluded gross receipts from certain sales of securities. We also conclude that only Delco, a member of General Motors California unitary group, was entitled to a research credit against its taxes, and that General Motors is not entitled to certain deductions related to foreign taxes. As to the Franchise Tax Board's cross-appeal, we conclude that the superior court correctly found unconstitutional Revenue and Taxation Code section 24402,[1] which provides an income tax deduction for certain dividends received from other corporations.

FACTUAL BACKGROUND

General Motors Corporation is a Delaware corporation, and its commercial domicile is located in the State of Michigan. General Motors and certain affiliated corporations (collectively, GM) engage in a "unitary business" that operates partially within California. A unitary business is one that receives income "from or attributable to sources both within and without the state . . . ." (§ 25101.) "A unitary business is generally defined as two or more business entities that are commonly owned and integrated in a way that transfers value among affiliated entities." (*Citicorp North America, Inc. v. Franchise Tax Bd.* (2000) 83 Cal.App.4th 1403, 1411, fn. 5 (*Citicorp*).) Not all of the corporations in the GM "unitary group" are subject to taxation in California.

"If a unitary business exists, taxes are apportioned by formula to allocate to California for taxation, 'its fair share of taxable values of the taxpayer . . . .' (*Butler*

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[1] Unless otherwise noted, all further statutory references are to the Revenue and Taxation Code of California.

Brothers v. McColgan [(1941)] 17 Cal.2d 664, 667-668.)" (*Citicorp, supra,* 83 Cal.App.4th at p. 1411.) Thus, GM files a single combined "Unitary Corporate Tax Return" in California. (See *Colgate-Palmolive Co. v. Franchise Tax Bd.* (1992) 10 Cal.App.4th 1768.) The income reported in the unitary return arises out of numerous commercial activities including investment in securities. That income is then apportioned among the members of the unitary group that are subject to taxation in California.

Respondent Franchise Tax Board of the State of California (the FTB) conducted a lengthy field audit at the corporate offices of GM in Michigan. (The audit apparently commenced in 1991 with the principal audit work being accomplished in 1992. The audit concluded in 1997.) The audit pertained to the 1986-1988 income years. Both prior to and after the audit, GM paid all the taxes involved ($19,586,850). GM filed claims for refund (totaling $8,983,063) on December 11, 1997. GM also filed protests as the result of certain adjustments made during and after the audit.

To apportion income of unitary businesses, California has adopted the Uniform Division of Income for Tax Purposes Act (UDITPA, § 25130 et. seq.), as have numerous other states. In apportioning GM's worldwide income (i.e., that income attributable to GM's unitary group), UDITPA and thus California law require the use of a percentage derived from a statutory formula that is based on three factors: payroll, property and sales.[2] Section 25134 (as amended by Stats. 2000) provides: "The sales factor is a

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[2] The formula is set forth in Revenue and Taxation section 25128, subdivision (a). The "property factor" is defined in section 25129. The "payroll factor" is defined in section 25132. And the "sales factor" is defined in section 25134. The formula is: $\mathbf{TI_{CA} = TI_{WW} \times 1/3\ (Receipts_{CA}/Receipts_{WW} + Payroll_{CA}/Payroll_{WW} + Property_{CA}/Property_{WW})}$
Where

1. TI_{CA} is the taxpayer's total taxable income apportioned to California.
2. TI_{WW} is the taxpayer's total worldwide taxable income apportionable under California law.
3. $Receipts_{CA}$ is the taxpayer's gross receipts within California.
4. $Receipts_{WW}$ is the taxpayer's gross receipts worldwide.

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." Section 25120, subdivision (e), defines "'[s]ales'" as "all gross receipts of the taxpayer . . . ." Thus, in this formula, the sales factor is represented by a fraction, the denominator of which is based on "all gross receipts" of the taxpayer "everywhere" in the world. Consequently, the smaller the "gross receipts" number in the denominator, the larger the portion of the taxpayer's income that is taxable to California; conversely, the larger the denominator of the fraction is, the less the amount of tax. Although "sales" is defined as "all gross receipts," "gross receipts" is nowhere defined in the statute.

GM maintains a "Treasury Department" in New York City. The Treasury Department manages the excess cash of GM and its various related corporate entities and subsidiaries in the United States. For GM, "excess cash" means that cash on any particular day that GM is not actually going to spend. (Or, as another GM official stated, "[a]ny cash that wasn't needed for funding forecasted payments.") The major share of GM's cash is derived from sale of motor vehicles and motor vehicle parts. The investment activities of GM's Treasury Department often produce a significant portion of GM's net income. Sometimes GM's "tax and financial staff" produce more of GM's profits than its manufacturing operations. During the tax years at issue here, GM's net corporate income totaled over $7 billion of which the Treasury Department generated over a half billion dollars in income.

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5. Payroll_{CA} is the taxpayer's payroll in California.
6. Payroll_{WW} is the taxpayer's worldwide payroll.
7. Property_{CA} is the value of the taxpayer's property located in California.
8. Property_{WW} is the value of the taxpayer's property located anywhere else in the world.

During the tax years at issue in this appeal (1986-1988), the Treasury Department used its excess cash to purchase various marketable securities, which are characterized as "liquid assets." These investments would be in such items as U.S. Treasury bonds, notes, and bills as well as bank certificates of deposit (CD's), etc., that bore maturity dates at which times both principal and interest were returned to GM. The security transactions fall into three categories: (1) direct sales, (2) maturities, and (3) repurchase agreements. The parties by stipulation agreed that "'direct sales'" of securities (6 percent of GM's Treasury Department proceeds from security transactions) were defined "as the sale of a security, other than a sale pursuant to a repurchase agreement, that occurred before the date the security matures at the end of its stated term." Approximately 90 percent of the proceeds listed by GM as gross receipts are from "repurchase transactions" (i.e., pursuant to a written master agreement, the securities broker repurchases or sells the security held in GM's account.) The repurchase transaction would occur either on a date certain or upon demand.[3] The balance of the gross receipts is from "maturities," which constitute 4 percent of the Treasury Department securities proceeds.

In its initial California tax returns, GM treated the majority of the Treasury Department income as nonbusiness income, not subject to taxation in California. But on audit, the FTB treated all of GM's treasury income as business income subject to California apportionment and taxation. And in its audit adjustments of GM's tax returns and in calculating income to be apportioned to California for tax purposes, the FTB considered as gross receipts only GM's net proceeds from the Treasury Department's securities transactions and excluded gross proceeds from such transactions.

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[3] The repurchase transaction amounts for the tax years in question here resulted in the following gross proceeds:

1986: $331,521,760,774 (89.9%)
1987: $221,546,697,571 (92.6%)
1988: $315,386,083,908 (87.55%)

According to GM, the proceeds from the redemption of these securities are all "gross receipts," totaling almost a trillion dollars ($968,741,764,769) over the three-year period. Thus, according to GM's numbers, the average annual gross return from these investments is about $309 billion. But GM admitted that the average balance of its investment in short-term securities during the tax years at issue was approximately $2.75 billion. This fact led to the FTB's conclusion that GM rolled over its short-term marketable securities every 3.25 days. GM's investment policy allowed investment periods of from one day to two years. At times the maximum range for these investments was 40 to 45 days. GM also noted that the FTB's calculations resulted in the amount of income apportioned to California for the years 1986 through 1988 being almost 50 percent higher than GM postulated.

The FTB denied GM's claims and protests, causing GM to file an appeal with State Board of Equalization (the SBE). Subsequently, GM and the FTB jointly requested that the SBE deny the appeal without prejudice. GM and the FTB also stipulated that GM had exhausted its administrative remedies so as to permit GM to file a timely complaint in the superior court.

In part, the Treasury Department's income also consisted of dividends from various corporations as to which GM owned less than 50 percent sharehold interest. GM refers to these corporations as "its nonunitary subsidiaries." During the tax period in question, GM received approximately $4 million in dividends from these corporations. The FTB treated these dividends as business income and did not permit GM to take a deduction for them.

General Motors Acceptance Corporation, one of GM's corporate entities, received a total of $314 million in dividends from its unitary subsidiary Motors Insurance Company during the years 1986 through 1988. Motors Insurance Company pays a gross premiums tax in lieu of the corporation franchise tax and maintains its own separate management. The FTB did not permit GM to take a deduction for these dividends.

GM claimed a $2,844,797 research credit for the 1988 tax year pursuant to section 23609. For 1988, GM calculated that the California franchise tax liability of Delco, as noted earlier, another of GM's corporate entities, was approximately $6,620,967. The Treasury Department controls and intermingles the cash of GM and its subsidiaries. GM asserts that funds earned by corporations in the unitary group (those corporations that GM controls by virtue of a sharehold interest of 50 percent or more) help fund the research activities generated by the research credit. The FTB allowed only a credit of approximately $1 million.

Foreign countries withheld foreign taxes on various "intercompany" dividends, royalties, rents and interest (which GM refers to collectively as "Intercompany Dividends") paid to GM. These taxes totaled approximately $210 million for the three-year tax period. Pursuant to section 24345, GM deducted these taxes. The FTB disallowed the deduction on the ground that the foreign taxes paid on intercompany dividends constituted taxes on or measured by income or profits and are excluded under subdivision (b)(1) of section 24345. The FTB eliminated the intercompany dividends from the calculation of GM's income and eliminated intercompany rents, intercompany royalties, and intercompany interest income from the calculation of GM's income as well.

PROCEDURAL BACKGROUND

GM filed a complaint for refund of taxes, setting forth nine causes of action, all pertaining to the "income years" of 1986, 1987 and 1988. After the FTB filed its answer, GM moved for summary adjudication as to five of the eight remaining causes of action.[4] Shortly thereafter, the FTB filed a cross-motion for summary adjudication as to two of the causes of action.

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[4] GM characterized the remaining three causes of action as "minor" once [the other five] are decided."

The trial court denied GM's motion for summary adjudication as to three causes of action and granted the motion as to two causes of action. The court also granted the FTB's cross-motion for summary adjudication as two causes of action.

Then the parties stipulated that certain "Causes of Action are resolved by the parties . . . making the case ready for appeal by the parties. . . ." As to these causes of action, the parties incorporated "Table A" (see appendix to this opinion) into their stipulation and further stipulated, "for the purposes of this case only, that 90% of the . . . 'Direct Sales' for the years at issue . . . [per Table A] are includable in the denominator of plaintiff's apportionment factor under Section 25134. The parties further agree that, for the purposes of this case only and without prejudice to any other tax year, ten percent of all of the amounts referred to in Table A . . . shall be deemed to relate to plaintiffs' nonbusiness income activities and would not therefore be includable in plaintiff's apportionment factors regardless of the outcome of any appeal in this case. The parties further agree that inclusion of plaintiffs' Direct Sales amounts by themselves under section 25134 for the years at issue will not bring into play, were it otherwise applicable (a point upon which the parties disagree), Revenue and Taxation Section 25137. However, the FTB shall not be precluded from contending, in any further proceedings in this case, that . . . Section 25137 is applicable if the additional amounts from Table A are included under Section 25134, and contending that Section 21537 applies to any and all amounts from Table A that might be included under Section 25134 (which amounts relate to business income), including the Direct Sales amounts. The parties further agree that the judgment . . . shall include, as part of the payment in refund of California franchise taxes paid for 1986 to 1988, amounts based on the inclusion of the ninety percent of 'Direct Sales' under Section 25134 (10% . . . being treated as nonbusiness income)."

Based on the trial court's statement of decision, the record of the hearing on the parties' motions and other stipulated agreements, the parties further agreed by stipulation "that a trial . . . would be unnecessary" and that they had entered into the stipulation "to facilitate the resolution of this matter so as to enable the parties to pursue their respective

appeal rights without further wasting the resources of the parties or the [Trial] Court with unnecessary litigation."

The parties also compromised regarding the issue of what was and was not business income without prejudice to any tax years except 1986-1988, by stipulating "that the following amounts of income that were treated as plaintiffs' apportionable business income by the FTB . . . shall be recharacterized as nonbusiness income amounts that are not subject to taxation by California during the years at issue: $23,939,925, $11,593,808, and $19,699, 916." Thus, approximately $497 million of GM's income was agreed to be business income apportionable to California.

The parties also stipulated "that plaintiffs' apportionment sales factor denominator may be increased from the amounts allowed in the FTB's Notices of Proposed Assessment for the years 1986, 1987 and 1988 by $46,856,972, $51,228,448 and $178,146,316, respectively." The parties also compromised and resolved other issues that are not germane to the issues on appeal.

Based upon its rulings on the motions for summary adjudication and on the parties' stipulation to judgment, the trial court entered a judgment finding that GM overpaid its California franchise taxes in the amounts $697,206, $669,616, and $631,804, respectively. The judgment awarded GM a refund in the total sum of $7,439,240.99 (including the overpayment and interest owed for the 1986-1988 tax period).

GM filed a notice of appeal from the judgment. GM contends that (1) the FTB cannot under section 24134 exclude gross receipts from the sale of securities from the sales factor, (2) the FTB cannot restrict the research tax credit to one member of the California Unitary Group, and (3) taxes on intercompany dividends, interest, rents and royalties are deductible for tax years occurring before a 1992 statutory change.

The FTB filed a notice of cross-appeal from "the Judgment to the extent that it incorporates the granting of summary adjudication in favor of plaintiffs on the claim set forth in the Third Cause of Action" of GM's complaint "and the ruling that Section

24402 of the California Revenue and Taxation Code is unconstitutional." The FTB contends that section 24402 is constitutional.

DISCUSSION

I. Standard of Review

The facts in this case are undisputed, and the resolution of this appeal does not rest upon any interpretation of facts by the trial court. Nor does our analysis depend upon any significant determination of factual issues. Rather, our determination of the issues rests on application of the statutory law and legal principles. (*Board of Education v. Jack M.* (1977) 19 Cal.3d 691, 698.) Thus, our review is independent, or "de novo," and is confined essentially to questions of law. (Eisenberg et al., Cal. Practice Guide: Civil Appeals and Writs (The Rutter Group 2003) ¶ 8:2, p. 8-1.)

II. Inclusion of Net Securities Proceeds in "Gross Receipts"

We conclude that the trial court correctly decided that the return of principal from securities transactions in the repurchase agreements and maturities categories should not be included as "gross receipts" in the denominator of the sales factor in apportioning income to California. The reason for this conclusion is that such a return of principal does not arise out of a sales transaction.

Section 25120, subdivision (e), defines "'[s]ales'" as "all gross receipts of the taxpayer . . . ." The parties have excluded from our concern GM's "direct sales" of securities. It is reasonably clear that such transactions do constitute sales. However, the UDITPA does not otherwise define "gross receipts." Thus, aside from the obvious determination that "gross receipts" must be sales, we are left without statutory guidance. The question we face then is whether GM's transactions involving repurchase agreements and maturities constitute sales. We conclude that they do not.

GM relies on tax cases from various UDITPA states that hold that "gross receipts" necessarily includes all investment transactions of this sort. We have reviewed GM's cited cases. For the most part, they uncritically decide that the statute is without any ambiguity and conclude without lengthy analysis that the transactions constitute "gross

receipts." We think the analysis is faulty insofar as it deems these "receipts" to be sales without scrutinizing the nature of the transactions.

In our view, the activity represented by these Treasury Department transactions is not akin to a sale at all but rather is more easily comparable to a taxpayer who takes "idle cash" or, merely to remain liquid, repeatedly deposits and withdraws his cash from his bank or savings and loan accounts. As decided in *American Tel. & Tel. v. Taxation Div. Director* (N.J.Super.A.D. 1984) 476 A.2d 800, 802: "We uphold as a general matter the exclusion of gross revenues received by plaintiff from the sale or maturity of investment paper. As [the trial judge] observed, 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 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.]"

We agree with the trial court that the *Sherwin-Williams* line of cases provides ample precedent from other states to uphold the trial court's interpretation of the statute. (*Sherwin-Williams v. Dept. of State Revenue* (Ind.Tax 1996) 673 N.E.2d 849, 853; *Sherwin-Williams Co. v. Johnson* (Tenn.App. 1998) 989 S.W.2d 710.)

In *Sherwin-Williams v. Dept. of State Revenue, supra*, 673 N.E.2d at page 850, the Indiana Tax Court reviewed the Indiana State Department of Revenue's determination

that apportionment cannot result from an inclusion of "rolled over" securities in the sales factor. The question was therefore whether the denominator of Sherwin-Williams's sales factor should be increased to include the principal or capital element of investments. The court's analysis centered on how to define "gross receipts." (*Id.* at p. 851.) The court especially focused on the notion that repeated rolling over of the investment would amount to an absurd abuse if these "same funds" could be included several times over in the gross receipts denominator. (*Id.* at p. 852.) The court thus 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. Thus, the Department was correct in including only the interest earned as part of the total receipts in the denominator of the sales factor of the apportionment formula." (*Id.* at p. 853.)

Certainly, as the FTB posits, the return of one's own funds is not a receipt from a sale. Therefore, while interest thereon is income, the taxpayer's capital funds are not proceeds from a sale. (See *County of Sacramento v. Pacific Gas & Elec. Co.* (1987) 193 Cal.App.3d 300, 311, and *City of Los Angeles v. Clinton Merchandising Corp.* (1962) 58 Cal.2d 675, 681.) The regulations pertaining to section 25134 also support the FTB view. Section 25134, subdivision (a)(1)(A), describes what is includable and excludable as gross receipts. That section states that "[g]ross receipts for this purpose means gross sales, less returns and allowances and includes all interest income." (Cal. Code Regs., tit. 18, § 25134, subd. (a)(1)(A).) As the FTB asserts, the procedure of subtracting returns recognizes that any sale is negated and that there is no receipt, except the interest. Although, the judiciary must take ultimate responsibility for the construction of a statute, we accord great weight and respect to the administrative construction. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 12.)

Respondent FTB also points out that GM did not report the proceeds from Treasury Department activities as sales on their federal tax returns, financial statements, or annual reports. It only reported the interest it received from the securities transactions.

Section 448 of the United States Internal Revenue Code (26 U.S.C. § 448)[5] allows taxpayers with under $5 million of gross receipts to compute their income using the cash method of accounting. Section 448 is incorporated into the California Revenue and Taxation Code by section 24654. The federal regulations relating to section 448 include the following provision: "Gross receipts do not include the repayment of a loan or similar instrument (*e.g.,* a repayment of the principal amount of a loan held by a commercial lender)." (26 C.F. R. § 1.448-1T(f)(2)(iv)(A).)

We are not persuaded by GM's argument invoking IRC section 1271, which provides that maturing securities are "exchanges." That provision does not relate to apportionment of income; instead it merely ensures that gain from discounted corporate debt instruments is treated as capital gain rather than as ordinary interest income. (*KVP Sutherland Paper Company v. United States* (Ct.Cl. 1965) 344 F.2d 377, 382.) Indeed, it is well settled that payment of an obligation or retirement of a maturity is not a sale or an exchange other than with regard to the limited exception of section 1271. (*Ibid*; *Graham v. C.I.R.* (2d Cir. 1962) 304 F.2d 707, 708, citing *Fairbanks v. United States* (1939) 306 U.S. 436.)

California has also concluded that security repurchase transactions should be considered loans. "Repurchase agreements, commonly known as 'repos,'" the California Supreme Court has held, " are . . . nothing more than financing arrangements by which one party provides funds to another for a short period of time. There are two parties to a repurchase agreement: one has money to lend, the other needs cash and has securities. The repurchase agreement itself consists of two transactions that are agreed to simultaneously, but are performed at different times: (1) the seller-borrower agrees to transfer securities to the buyer-lender in exchange for cash; and (2) the seller-borrower

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5 Hereinafter we shall refer to that code as the "IRC."

agrees to repurchase the securities from the buyer-lender at the original price plus 'interest' on a specified future date or upon demand." (*Bewley v. Franchise Tax Bd.* (1995) 9 Cal.4th 526, 529.) The United States Supreme Court came to essentially the same conclusion with regard to repurchase transactions. (*Nebraska Dept. of Revenue v. Loewenstein* (1994) 513 U.S. 123,134 [noting that "in economic reality the [taxpayer] receive[s] interest on cash [it has] lent . . ."].)

Thus, we conclude that maturities and so-called "repos" are not sales, but rather secured monetary transactions that are the equivalent of loans. Since the transactions are not sales, the return of capital is not includable in the sales factor as "gross receipts."

Having determined that GM's return of capital is not includable in gross receipts for purposes of income apportionment, we are not required to address the issue of the FTB's proposed application of section 25137. We therefore do not reach that question.

III. Limitation of 1988 California Research Credit

Section 23609 allows a credit against the "'tax' (as defined by Section 23036) in an amount determined in accordance with Section 41 of the Internal Revenue Code . . . ." Thus, the credit is for "research expenses" that are "paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer." (IRC § 41, subd. (b)(1).)

For the 1988 tax year, Delco had a tax liability of $1,026,402 based on the California taxable income attributed to it by application of the UDITPA apportionment formula to the GM unitary group. Delco had research expenses amounting to $2.8 million. The FTB allowed Delco to use the credit to offset all of its 1988 tax liability except the $300 minimum tax (which is not subject to the credit.) Thus, for the 1988 tax year, Delco received a research credit of approximately $1 million. Although Delco can (and apparently has) carried over the balance of the credit to subsequent tax years, GM contends that, since the tax liability is dependent upon apportionment of income to the unitary group, GM should have been able to use all of the entire $2.8 million credit as an offset to GM's entire 1988 California tax liability. We disagree.

GM asserts that the key question is who is the "taxpayer" and contends that the unitary group is the taxpayer. The FTB claims that, for the purpose of taking the research credit, Delco is the taxpayer.

As section 23609 states, the amount of expenses for research activities are "allowed as a credit against the 'tax' as defined by Section 23036 . . . ." Section 23036 lists the various taxes against which the credit applies and cites the relevant Revenue and Taxation Code provisions. The taxes to which the credit may be applied are:

"(A) The tax imposed under Chapter 2 (commencing with Section 23101).

(B) The tax imposed under Chapter 3 (commencing with Section 23501).

(C) The tax on unrelated business taxable income, imposed under Section 23731.

(D) The tax on S corporations imposed under Section 23802." (§ 23036, subd. (a)(1).)"

None of these refers to the allocation of income provisions of UDITPA (§ 25120 et seq.). Moreover, the credit is not allowable against taxable income but against the actual tax. And although the income of the unitary business is determined from the income of all of the corporations that are part of that business, taxes are only imposed on those corporations in the unitary group that are subject to California's tax jurisdiction. (*Citicorp, supra,* 83 Cal. App.4th at p. 1415.)

We fail to understand GM's argument of unfairness relating to Delco's potential California tax liability of $6 million on a separate company basis. On that basis certainly, Delco could have used the entire research expenses credit but still would have been obligated to pay more than $3 million in taxes. On the unitary basis, Delco only paid the $300 minimum tax. There was no unfairness to Delco. GM has not demonstrated any unfairness to the unitary group either, especially since the balance of the credit can be carried over. GM also acknowledges that under IRC section 41(f)(1)(A) such a credit is limited to each member of the unitary group in accordance with "its proportionate share of the expenses and basic research payments giving rise to the credit." GM merely argues that California did not incorporate this portion of IRC section 41.

We agree with the FTB that actual tax liability is imposed separately and individually upon each member of the unitary group that is subject to California taxation. This has long been the practice and principle in this state. (*Great Western Financial Corp. v. Franchise Tax Bd.* (1971) 4 Cal.3d 1, 5; *Safeway Stores, Inc. v. Franchise Tax Board* (1970) 3 Cal.3d 745, 752, fn. 8.)

The SBE, a quasi-judicial agency, has considered the contention that GM here makes and has held that an unused portion of a credit cannot be allocated to other corporate entities of the California unitary group that did not incur the expense upon which the credit is acquired. (*Appeal of Household Finance Corp.* (Nov. 20, 1968) 68 SBE 049 [1968 Cal.Tax LEXIS 3]; *Appeal of AeroVironment, Inc.* (Jan. 10, 1997) 97 SBE 001 [Cal.Tax Rptr. (CCH) ¶ 402-906.) "The Legislature has delegated to the SBE the duty of hearing and determining appeals from actions of the FTB. (§§ 19045-19048.)" (*Citicorp, supra,* 83 Cal. App.4th at p. 1418.) In view of its quasi-judicial capacity, the published opinions of the SBE are entitled to "great weight and respect" from the courts in interpreting the revenue and taxation statutes. (*International Business Machines v. State Board of Equalization* (1980) 26 Cal.3d 923, 931, fn. 7; *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, 524.) Courts particularly defer to the SBE's interpretation of taxation statutes where, as in the present case, the statutes at issue are part of a complex, interrelated, and at times rather arcane, statutory scheme. (*Yamaha Corp. of America v. State Bd. of Equalization, supra*, 19 Cal.4th at p. 12.)

GM's reliance on *Citicorp, supra,* 83 Cal.App.4th 1403, to bolster its claim that the unitary group is the taxpayer is misplaced. *Citicorp* does discuss the definition of "taxpayer," but only for the purposes of the so-called "throwback rule." (§ 25135, subd. (b).) More importantly *Citicorp* acknowledges that the FTB regulations under UDITPA use the term "taxpayer" in at least two senses and that the FTB is allowed under section 23030 to vary its definition "'where the context otherwise requires.'" (*Citicorp, supra,* 83 Cal.App.4th at p. 1420.) Moreover, *Citicorp* observes, with respect to the definition

of the term "taxpayer," that "the FTB is free to interpret the term as required by the context of the statute." (*Id.* at p. 1416.) Finally, *Citicorp* also recognizes that in proceeding under UDITPA, "the FTB is not taxing, but is apportioning income attributable to California." (83 Cal.App.4th at p. 1415.)

With regard to the remainder of the cases cited by GM, they have been taken out of context or do not bear directly on the allocation of credit issue. We therefore do not discuss them further.

We conclude the trial court properly limited the research credit to Delco and disallowed its applicability to the entire unitary group. The trial court therefore properly decided this issue.

In light of our determination on this issue in favor of the FTB position, we do not address the FTB's argument that GM is estopped from making this contention. That argument is based on the apparent fact that in years subsequent to 1988, Delco has consumed most of the remaining credit, leaving a balance of only approximately $400,000.

IV. Deduction of Foreign Taxes on Intercompany Transactions

Section 24345 allows a deduction "for taxes . . . paid or accrued during the income year, except: . . . (b) taxes on or according to or measured by income or profits paid or accrued within the income year imposed by the authority of . . . (1) . . . any foreign country." According to GM's complaint, various foreign governments withheld taxes on certain dividends, interest, rents, and royalties that members of GM's worldwide unitary group paid to other members. The trial court granted the FTB's cross-motion for summary adjudication on this issue, thus holding that GM was not entitled to any deduction for these foreign withholding taxes.

GM claims that these taxes, which foreign governments withheld from intercompany dividends, are not taxes "on or measured by income" and that they are deductible. GM's argument that these dividends are not from taxes "on or according to or measured by income" is premised on taking into account "intercompany eliminations"

under section 25106. Section 25106 states that "all dividends paid by one to another of those corporations shall, to the extent those dividends are paid out of the income previously described of the unitary business, be eliminated from the income of the recipient and, except for purposes of applying Section 24345, shall not be taken into account . . . in determining the tax of any member of the unitary group." The phrase "except for purposes of applying Section 24345" was added to section 25106 in a 1992 amendment.[6] GM thus argues that, since under the unitary taxation scheme the dividends are not considered by California as income, the withheld taxes are not "on or according to or measured by income."

We reject GM's argument. The taxes paid were clearly based "on or according to or measured by income." GM has not shown otherwise. GM merely claims that the 1992 amendment is not retroactive. The claim is unavailing. The 1992 amendment simply eliminated the ambiguity that GM now relies on. The amendment of section 25106 did not change section 24345.

Moreover, as the FTB contends, the IRS forms submitted by GM to support these deductions prove the income basis of these taxes. GM submitted IRS Forms 1118, entitled "Computation of Foreign Tax Credits." Federal foreign tax credits are generally available only for foreign income taxes paid or withheld. (IRC § 901, 903.) Moreover, the foreign government withholds the tax precisely because the dividend is only paid when the local corporation has generated income upon which to pay the dividend. The California elimination is applied as to "recipient," not to the payer of the dividend.

GM bears the burden of proof to show clearly that it is entitled to the deduction for foreign taxes and that such taxes were not taxes imposed "'on or according to or measured by income.'" (*Robinson v. Franchise Tax Board* (1981) 120 Cal.App.3d 72,

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[6] The 1992 amendment also replaced the phrase "any such corporation" with "the recipient."

77.) It has not met its burden. Furthermore, "deductions, like credits and exemptions, are to be narrowly construed against the taxpayer." (*Great Western Financial Corp. v. Franchise Tax Bd., supra,* 4 Cal.3d at p. 5.)

We believe that California Supreme Court's decision in *Beamer v. Franchise Tax Board* (1977) 19 Cal.3d 467, is controlling and resolves any ambiguity in the statute. There, the Supreme Court faced the question of deductibility of "occupation taxes" paid to the state of Texas respecting oil and gas royalties received by California taxpayers. The California taxpayers reported the royalties as income on their individual California tax returns but claimed deductions under former section 17204.[7] Former section 17204 was a companion provision to section 24345, applied to individual taxpayers, and likewise disallowed deductions for "[t]axes on or according to or measured by income . . . imposed by authority of . . . . any foreign country [or] . . . [a]ny [s]tate . . . ." Ultimately, the Supreme Court determined that "occupation taxes" are not taxes "on or according to or measured by income" and thus are deductible. But in its decision, the Supreme Court initially resolved whether the exclusion of deductions for taxes based on income and paid to other states was rendered nugatory, or was trumped, by the general provision allowing the deduction of other foreign taxes. For that determination, the Supreme Court assumed that the Texas taxes were based on income. (19 Cal.3d at pp. 470-474.) On this issue, the Supreme Court rejected the taxpayer's argument that the exclusion of the deduction clause was inapplicable and concluded that "the Legislature did not intend . . . to alter any existing provisions prohibiting the deduction of certain types of taxes, specifically taxes on or measured by income . . . ." (*Id.* at p. 474.) This analysis, by parity of reasoning, applies also to the issue presented by GM. We therefore conclude that the exclusion of section 24345 applies despite the intercompany elimination provisions of section 25106.

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[7] Former section 17204 has since been repealed.

In addition, the SBE in *Appeal of CTI Holdings, Inc.* (Feb. 22, 1996) 96 SBE 003 [Cal.Tax Rptr. (CCH) ¶ 402-483], addressed each of the arguments GM now makes and rejected all of them. The SBE held that dividends and royalties were income and that the elimination of intercompany transactions under California's unitary reporting rules does strip the foreign taxes of their character as taxes on or measured by income. (*Ibid*.) Again, we accord the decisions of the SBE great weight and respect, and GM has provided no valid grounds to reject the decision in *CTI*, *supra*.

GM is not assisted by its reliance on the dictum in *Pacific Tel & Tel. Co. v. Franchise Tax Bd.* (1972) 7 Cal.3d 544. That decision addresses the interpretation of section 24344 concerning the computation of a deduction for interest respecting a unitary business entity vis-à-vis an offset for certain interest and dividend income. In discussing the application of the offset, the Supreme Court references dividends and then notes in footnote 11: "Section 25106 provides both that intercompany dividends are *not income and that they shall be excluded from the* [§ 24344, subd. (b)] *computation.*" (*Pacific Tel & Tel. Co. v. Franchise Tax Bd., supra,* 7 Cal.3d at p. 558, fn. 11; italics in original.) Section 25106 was not at issue in *Pacific Tel & Tel. Co. v. Franchise Tax Bd., supra,* 7 Cal.3d 544, and the opinion does not analyze that section nor address its relationship to section 24345. "The doctrine of stare decisis does not extend to points not raised in the briefs and decided by the court. 'An opinion is not authority for a point not raised, considered, or resolved therein.' (*Styne v. Stevens* (2001) 26 Cal.4th 42, 57; *People v. Banks* (1993) 6 Cal.4th 926, 945.)" (Eisenberg et al., Cal. Practice Guide: Civil Appeals and Writs (The Rutter Group 2003) ¶ 14:196.5, p. 14-66.2) The Supreme Court's opinion also does not involve the deduction or elimination of intercompany dividends as to a unitary business or in filing a combined report. Ultimately, the Supreme Court concluded that intercompany dividends are not income for the purpose of the computing the interest offset in accordance with section 24344. In any event, the Supreme Court's bare statement in footnote 11 goes against the weight of authority, which includes

dividends within the definition of gross income. (See *Appeal of CTI Holdings, Inc.*, *supra*, 96 SBE 003 [Cal.Tax Rptr. (CCH) ¶ 402-483].)

We therefore find that the trial court properly granted the FTB's cross-motion for summary adjudication as to the interpretation of section 24345.

V. Limitation on Deduction of Dividends

As to the third cause of action of GM's complaint, alleging discriminatory treatment of dividend deductions pursuant to section 24402, the trial court found in favor of GM, granting its motion for summary adjudication and finding that section 24404 is unconstitutional. Section 24402 allows a corporate taxpayer to deduct a portion of the dividends it receives from another corporation if the dividends were included in dividend payer's measure of California franchise tax.

Since the trial court's decision, Division One of our appellate district held in *Farmer Bros. Co. v. Franchise Tax Bd.* (2003) 108 Cal.App.4th 976, (*Farmer Bros*.) that section 24402, known as the "dividends received deduction," violates the commerce clause of the United State Constitution and is thus unconstitutional. The California Supreme Court denied review of that decision. *Farmer Bros.* is dispositive.

The Court of Appeal rejected all of the arguments the FTB presents to us and concluded that the tax, as computed with respect to section 24402, violates the commerce clause. In its well-reasoned opinion, Division One found that section 24402 is facially discriminatory. We agree. Citing *Ceridian Corp. v. Franchise Tax Bd*. (2000) 85 Cal.App.4th 875, *Farmer Bros.* first notes that the commerce clause of the United States Constitution denies states the power to discriminate without justification against interstate commerce. (*Farmer Bros., supra,* 108 Cal.App.4th at 985.) As *Farmer Bros.* observes, a tax may violate the commerce clause even where "'it has no discriminatory goal or intent, if it is facially discriminatory, or has the *effect* of unduly burdening interstate commerce.'" (*Id.* at p. 986, citing *Ceridian Corp. v. Franchise Tax Bd*., *supra* at p. 884.)

Citing *Fulton Corp. v. Faulkner* (1996) 516 U.S. 324 (*Fulton*), *Farmer Bros.* takes note that "a state law is treated as discriminatory if it taxes a transaction or incident more

heavily when it crosses state lines than when it occurs entirely within the state." (*Farmer Bros., supra,* 108 Cal.App.4th at p. 986.) Citing *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.* (1994) 511 U.S. 93, 100-101, *Farmer Bros.* further observes that a facially discriminatory state law will be invalidated "unless the state can show that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." (108 Cal.App.4th at p. 986.)

Farmer Bros. holds "that section 24402 is discriminatory on its face because it affords to taxpayers a deduction for dividends received from corporations subject to tax in California, while no deduction is afforded for dividends received from corporations not subject to tax in California. As a result, the dividends received deduction scheme favors dividend-paying corporations doing business in California and paying California taxes over dividend-paying corporations which do not do business in California and pay no taxes in California. The deduction thus discriminates between transactions on the basis of an interstate element, which is facially discriminatory under the commerce clause." (*Farmer Bros., supra,* 108 Cal.App.4th at pp. 986-987.) We agree.

Farmer Bros. correctly rejects the FTB's claim that section 24402 does not violate the "internal consistency doctrine" in assessing whether the tax is discriminatory. "'The internal consistency doctrine requires that the imposition of a tax identical to a challenged tax in every state would add no burden to interstate commerce that intrastate commerce did not also bear, and looks at the structure of the challenged tax to see whether its identical application by every state would place interstate commerce at a disadvantage against intrastate commerce.' (*D.D.I., Inc. v. State* (2003) 2003 N.D.32 [657 N.W.2d 228, 234] (*D.D.I.*) [similar dividends received deduction held unconstitutional under commerce clause and was not a valid compensatory tax].) Here, the imposition of the dividends received deduction by every state would favor intrastate commerce over interstate commerce by giving a greater tax benefit to taxpayers investing in their home state corporations as opposed to out-of-state corporations or corporations engaged in

multistate business. Section 24402 violates the internal consistency doctrine." (*Farmer Bros., supra,* 108 Cal.App.4th at pp. 988-989.)

If a tax is truly a "compensatory tax," that is, one designed to have interstate commerce bear a burden already being borne by intrastate commerce, then a facially discriminatory tax may overcome the commerce clause scrutiny it must face. (*Fulton, supra*, 516 U.S. at p. 331; *Farmer Bros., supra,* 108 Cal.App.4th at p. 989.) The FTB makes the argument here as in *Farmer Bros., supra*, that section 24402 is a compensatory tax provision, designed to avoid double taxation. Based on reasoning set forth in *Fulton, supra*, 516 U.S. 324, and in *D.D.I., supra,* 657 N.W.2d 228, *Farmer Bros.* found that the FTB failed to establish any of the three conditions or prongs necessary to validate a tax as compensatory. (*Farmer Bros., supra,* 108 Cal.App.4th at pp. 989-993.) As set forth in *Fulton, supra,* these prongs are described as follows: "The cases have distilled three conditions, or prongs, necessary for a valid compensatory tax: (1) A state must, as a threshold matter, identify the intrastate tax burden for which the state is attempting to compensate, (2) the tax on interstate commerce must be shown roughly to approximate, but not exceed, the amount of the tax on intrastate commerce, and (3) the events on which the interstate and intrastate taxes are imposed must be substantially equivalent, that is, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other. (*Fulton, supra*, 516 U.S. at pp. 332-333.)" (*Farmer Bros., supra,* at p. 989.)

As to the first prong--identifying the intrastate burden for which the state is attempting to compensate--*Farmer Bros.,* relying on *Fulton, supra*, 516 U.S. at page 335, and on *D.D.I., supra*, 657 N.W.2d at page 234, rejected the FTB claim that the dividends received deduction avoids double taxation for out-of-state corporate income. (*Farmer Bros., supra,* 108 Cal.App.4th at pp. 989-990.) We likewise find that the claim lacks support and that the FTB has not shown an in-state benefit to the taxpayers.

As to the second prong--a showing that the tax on interstate commerce roughly approximates the amount of the tax on intrastate commerce--we agree with the court in *Farmer Bros.* that in light of the analysis and dispositions set forth in *Oregon Waste*

Systems, Inc. v. Department of Environmental Quality of Ore., supra, 511 U.S. at page 104, and in *Fulton, supra*, 516 U.S. at pages 336-338, the burden is a difficult one that the FTB has been unable to meet. (*Farmer Bros., supra,* 108 Cal.App.4th at pp. 990-991.)

Finally as to the third prong--substantial equivalence of the events upon which the intrastate and interstate taxes are imposed--*Farmers Bros.* states: "The third prong of the compensatory tax doctrine requires that the compensating taxes fall on substantially equivalent events. [The] FTB argues that this condition is met because corporate income and the dividend paid from that income are the 'same dollars' and are substantially similar events. Yet, *Fulton* expressly disapproved of this analysis with respect to the intangibles tax. '[W]e find that the intangibles tax is not functionally equivalent to the corporate income tax.' (*Fulton, supra*, 516 U.S. at p. 339.) Because the objective of the equivalent-event requirement is to enable in-state and out-of-state businesses to compete on an equal footing, '[t]his equality of treatment does not appear when the allegedly compensating taxes fall respectively on taxpayers who are differently described, as, for example, resident shareholders and corporations doing business out of state. A State defending such a tax scheme as one of complementary taxation, therefore, has the burden of showing that the actual incidences of the two tax burdens are different enough from their nominal incidences so that the real taxpayers are within the same class, and that therefore a finding of combined neutrality on interstate competition would at least be possible.' (*Id.* at p. 340.) [¶] The court in *Fulton* noted that determining whether the tax burden is shifted out of state, rather than borne by in-state producers and consumers, requires complex factual inquiries, and that courts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. (*Fulton, supra*, 516 U.S. at pp. 341-342.) 'Indeed, the general difficulty of comparing the economic incidence of state taxes paid by different taxpayers upon different transactions goes a long way toward explaining why we have so seldom recognized a valid

compensatory tax outside the context of sales and use taxes.' (*Id.* at p. 342.)" (*Farmer Bros., supra,* 108 Cal.App.4th at p. 992.)

Farmer Bros. thus explains that the "FTB must establish that the burden created by the structure of the dividends received deduction falls on the same class of taxpayers as does the corporate income tax. Yet the burden of section 24402 is on the taxpayer receiving dividends, while the burden of the corporate income tax is on the payer corporation. [The] FTB has failed to offer any factual or logical support for its claim that the actual incidences of these two taxes are imposed upon the same class of taxpayers (see *Fulton, supra*, 516 U.S. at p. 340, fn. 6) or that the dividends received deduction amounts to a clear equivalent for the corporate income tax." (*Farmer Bros., supra,* 108 Cal.App.4th at p. 992.)

We therefore agree with the court in *Farmer Bros.* that in light of the doubts expressed in *Fulton, supra*, 516 U.S. at page 344, about the corporate income taxes amounting to a "clear equivalent" (*ibid*.) as to the shareholder's burden imposed by intangibles taxes, the FTB has not established the third prong of the compensatory tax doctrine. Inasmuch as the state is unable to justify section 24402 as a compensatory tax, we further agree with the court in *Farmer Bros., supra,* that this statute violates the commerce clause because it impermissibly discriminates against interstate commerce.

As to the FTB's claim that the equitable doctrine of laches applies to bar the refund because GM did not raise its constitutional claim until years had passed, we agree with GM that the trial court impliedly denied the FTB's claim by ordering a refund. Moreover, we find that the trial court did not abuse its equitable discretion. The FTB has not shown that GM was dilatory in filing this action or its claim for refund. We also do not believe that the FTB has suffered any prejudice by reason of the timing of GM's claim of unconstitutional discrimination. We therefore reject the FTB's claim that laches should be applied.

DISPOSITION

The judgment is affirmed.

CERTIFIED FOR PUBLICATION.

BOREN, P.J.

We concur:

NOTT, J.

ASHMANN-GERST, J.

APPENDIX

TABLE A

1986

	U.S. Agencies	T-Bills	T-Notes	CDs	Corp. Securities	Total
Direct Sales	$725,325,275	$23,260,847,776	$551,715,605	$0	$0	$24,537,883,656 (6.6%)
Maturities	1,444,276,542	6,453,162,487	82,000,000	836,000,000	4,043,310,000	$12,858,749,029 (3.5%)
Repurchases	287,650,000	199,547,409,545	230,686,701,228	0	0	$331,521,521,760,774 (89.9%)
TOTAL	$2,457,817	$130,261,419,808	$231,320,416,835	$836,000,000	$4,043,310,000	$368,918,393,459

1987

	U.S. Agencies	T-Bills	T-Notes	CDs	Corp. Securities	Total
Direct Sales	$312,740,587	$8,583,576,790	$1,130,001,710	$0	$159,956,721	$10,366,275,809 (4.4%)
Maturities	55,860,000	4,000,000	0	3,064,100,000	4,133,216,871	$7,257,176,871 (3%)
Repurchases	0	56,203,779,391	165,342,918,179	0	0	$221,546,697,571 (92.6%)
TOTAL	$368,600,588	$64,791,356,182	$166,652,919,890	$3,064,100,000	$4,293,173,592	$239,170,150,251

1988

	U.S. Agencies	T-Bills	T-Notes	CDs	Corp. Securities	Total
Direct Sales	$406,276,600	$2,150,723,277	$249,928,711	$50,000,000	$20,555,400	$2,877,483,987 (8%)
Maturities	363,941,378	6,500,000	2,500,000	6,773,899,480	35,234,812,305	$42,381,653,163 (11.7%)
Repurchases	50,697,621	35,249,485,506	279,985,900,781	0	100,000,000	$315,386,083,908 (87.5%)
TOTAL	$820,915,599	$37,406, 708, 784	$280,238,329,492	$6,831,899,480	$35,355,367,705	$360,653,221,059