

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
BED BATH & BEYOND, INC.,) OTA NO. 18011340
)
)
 APPELLANT.)
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TRANSCRIPT OF VIRTUAL PROCEEDINGS

State of California

Tuesday, October 26, 2021

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Virtual Proceedings,
taken in the State of California, commencing
at 9:37 a.m. and concluding at 12:26 p.m. on
Tuesday, October 26, 2021, reported by
Ernalyn M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: ALJ TOMMY LEUNG

Panel Members: ALJ MIKE LE
ALJ CHERYL AKIN

For the Appellant: ERIC TRESH
TIM GUSTAFSON
D. DENENBERG

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

THOMAS LO GROSSMAN
CRAIG SWIESO

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-13 were received at page 6.)

(Department's Exhibits A-M were received at page 6.)

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California; Tuesday, October 26, 2021

9:37 a.m.

JUDGE LEUNG: We are ready to go on the record for Appeal Number 18011340 Bed Bath & Beyond, Inc., for the taxable years: End of February 2011, February 2010, February 2009.

Today is October 26th, 2021, and it's approximately 9:45 in the morning. My name is Tommy Leung. And along with Judges Akin and Le, we will be deciding the outcome of this case.

May I have the parties please state their appearances for the record, beginning with you, Mr. Gustafson.

MR. GUSTAFSON: Tim Gustafson with Eversheds Sutherland on behalf of Appellant Bed Bath & Beyond.

MR. TRESH: This is Eric Tresh with Eversheds Sutherland on behalf of Bed Bath & Beyond.

JUDGE LEUNG: Thank you.
Franchise Tax Board?

MR. LO GROSSMAN: This is Thomas Lo Grossman on behalf of Franchise Tax Board.

MR. SWIESO: Craig Swieso on behalf of the Franchise Tax Board.

JUDGE LEUNG: Thank you gentleman.

1 Exhibits for the record, I am admitting into the
2 record Exhibits A, as in apple through M as in Milk Duds
3 for the Franchise Tax Board and Exhibits 1 through 13 for
4 the Appellants with no objections.

5 (Appellant's Exhibits 1-13 were received
6 in evidence by the Administrative Law Judge.)

7 (Department's Exhibits A-M were received in
8 evidence by the Administrative Law Judge.)

9 And we are sealing Exhibit 9, 10, 11, G, as in
10 George, I, as in Isaac. And the parties and the judges on
11 the panel are all reminded that when referring to those
12 exhibits, to please refer to them by the exhibit numbers
13 and not to mention the names of the vendors.

14 We do have a motion from Mr. Gustafson concerning
15 the exhibits. Mr. Gustafson?

16 MR. GUSTAFSON: Thank you, Your Honor.

17 This is a function of doing this remotely
18 combined with the fact that we have three exhibits
19 admitted under seal. Those are Exhibits 9, 10, and 11
20 that you just went through. Whereas, during our direct
21 examination of Mr. Taplits, we would like to discuss some
22 of these exhibits. But given they are under seal, we do
23 not want to post them -- screen share, for purposes of the
24 presentation.

25 So we circulated, prior to hearing, pages from

1 the exhibits with certain questions highlighted that we
2 specifically wish to address. So our request to the panel
3 is we can use those highlighted copies simply for purposes
4 of facilitating with his testimony. They will not be
5 shown on the screen, but we will use them in our case in
6 chief.

7 JUDGE LEUNG: Okay. Mr. Gustafson, I got most of
8 that. I think I got all of it, but it would help you
9 maybe being closer to the mic so it would be clearer. But
10 we were able to get most of that.

11 Mr. Lo Grossman, any objections?

12 MR. LO GROSSMAN: No objections, Your Honor.

13 JUDGE LEUNG: Thank you.

14 So yes, the exhibits that you submitted this
15 morning, the ones that are under seal, yes, that will be
16 fine, and you can have the witness refer to them. That's
17 it.

18 The issues to be determined in this hearing
19 concern the sales factor:

20 Number one, whether the treasury function of Bed
21 Bath & Beyond should be included in the sales factor.

22 Number two, whether the vendor allowances should
23 be included in the sales factor.

24 The taxable years at issue are taxable years
25 ending February 2011, February 2010, and February 2009.

1 Mr. Gustafson, it's my understanding you have an
2 opening statement to make?

3 MR. GUSTAFSON: Yes, Your Honor. And with regard
4 to my audio, if the -- is this better if I'm speaking
5 directly into the microphone?

6 JUDGE LEUNG: Yes. That is much better. Thank
7 you.

8 MR. GUSTAFSON: Wonderful. Thank you very much.
9 If necessary, please let me know and I can dial in via
10 phone if that's better for the panel. But to jump right
11 into our opening statement as --

12 JUDGE LEUNG: Just one second, Mr. Gustafson.
13 Hang on for a second.

14 Mr. Lo Grossman, do you have an opening statement
15 to make, or do you wish to make one?

16 MR. LO GROSSMAN: No opening statement for
17 Franchise Tax Board, Your Honor.

18 JUDGE LEUNG: Okay. Thank you.

19 Mr. Gustafson, you can basically go straight
20 through your opening statement and go into your
21 presentation without any break in the action, okay? So go
22 right ahead.

23 MR. GUSTAFSON: Thank you, Your Honor.

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OPENING STATEMENT

MR. GUSTAFSON: As you indicated that there are two issues in this case. We have two issues, but we have one statute. And that statute is California Revenue & Taxation Code Section 25120(e), and the definition of sales for purposes of --

(Phone interruption.)

Also, as you indicated that we have three tax years at issue; tax years ending February 2009, February 2010, and February, 2011. And during these years, the sales under the statute was defined to mean all gross receipts to the taxpayer other than receipts specifically allocated through the UDITPA provisions.

So the primary question before the panel is whether two types of receipts are properly considered sales under this definition and, thus, included in Bed Bath & Beyond sales factor. The first type of receipts is treasury function receipts. And like many large corporations, Bed Bath & Beyond has internal treasury function that manages its excess cash and invests in certain U.S. treasuries and other securities. And the question is here is whether the receipts from the sale of the securities are includable in the sales factor.

Starting with the statute, we say -- we say, you know, our argument is yes, it does. The statute says all

1 gross receipts not allocated. And here, there is no
2 contention that the treasury receipts should otherwise be
3 allocated. We also have a California Supreme Court
4 decision in Microsoft versus -- Microsoft Corp. versus the
5 Franchise Tax Board saying that treasury function receipts
6 are included in the sales factor under the statute.

7 And we also have the California legislature
8 saying that they are included in the sales factor up until
9 tax years beginning on/or after January 1st, 2011, after
10 the years at issue in this appeal. The second type of
11 receipts is vendor allowances. And here, like many large
12 retailers, Bed Bath & Beyond negotiates different
13 allowances with its vendors and negotiates corresponding
14 services and benefits that it provides to those vendors,
15 with an over-arching goal of promoting a vendor and its
16 products. Now, these vendor allowances are receipts to
17 Bed Bath & Beyond.

18 We have a similar question regarding this issue
19 with the treasury function issue are the receipts from the
20 vendor allowances includable in Appellant's sales factor.
21 Again, as with the first issue, we looked at the statute
22 that's during the years at issue define sales to mean all
23 gross receipts not allocated. Again, here there's been no
24 contention that vendor allowance receipts should be
25 allocated. We can also look to Microsoft and the

1 California Supreme Court's interpretation of sales and how
2 gross receipts as used in the definition of sales means
3 the full amount received.

4 So under the governing statute and California
5 Supreme Court precedent, the starting point is that both
6 types of receipts are includable in Bed Bath & Beyond
7 sales factor. That raises the question, well, okay.
8 What's the dispute here? Well, for the treasury function
9 issue, this is a pure legal issue as there's no facts in
10 dispute, but the Franchise Tax Board promulgated a
11 regulation under a different statute. That's California
12 Revenue & Taxation Code Section 25137, which is
13 California's alternative apportionment statute.

14 And that regulation specifically excludes
15 treasury function receipts from a taxpayer's sales factor
16 beginning for tax -- for tax years beginning on/or after
17 January 1st, 2007. So they promulgated this regulation
18 despite the fact that the California Supreme Court held
19 that the very same type of receipts are includable under
20 the governing statute in effect during the years at issue.

21 And more importantly, despite the fact that the
22 state legislature confirmed such receipts were included in
23 the sales factor during the years at issue. Well, and how
24 did the legislature do this? By amending the statute in
25 2009 to exclude treasury receipts, which is exactly what

1 the FTB did by regulation, but only for tax years
2 beginning on/or after January 1st, 2011.

3 So the question becomes, does the FTB's authority
4 supersede that of both the legislature and the California
5 Supreme court? No, it doesn't. There is no end around
6 available to the FTB, even through another statute. From
7 both the legislature and the state's high court has said
8 that these receipts, treasury function receipts, are
9 includable in the sales factor for these years, our years
10 at issue, years before January 1st of -- all years
11 beginning before January 1st, 2011.

12 Now, as for where the receipts should be sourced,
13 there's no dispute that they would be properly, if
14 includable in the sales factor, they are properly sourced
15 outside of California. For the -- now turning briefly to
16 the vendor allowance issue, they are both legal and
17 factual issues that we will be arguing and discussing
18 today. On the legal side, again, we point to the statute,
19 sales means all gross receipts.

20 And the Franchise Tax Board in its briefing has
21 pointed elsewhere. It has pointed to its own
22 administrative guidance, which imposes restrictions not
23 found in the statute or regulation regarding these types
24 of receipts, vendor allowances. Our primary position is
25 that the statute controls.

1 On the factual side, there are questions that
2 have been raised as to whether the Appellant has
3 substantiated its position. As it will be discussed this
4 morning, vendor allowances are supported by Bed Bath &
5 Beyond's returns, information in its books and records and
6 its public filings, and by witness testimony.

7 Today we will hear from Mr. Steve Taplits. He is
8 Bed Bath & Beyond's vice president of tax who will talk
9 more about the allowances, what they are, what benefits
10 and services Bed Bath & Beyond provides in exchange for
11 the corresponding payments, and more detail on -- more
12 context and detail about the allowances themselves.

13 Now, the secondary issue with regard to the
14 vendor allowances is where the receipts should be sourced.
15 Under California sourcing provisions, specifically, the
16 cost of performance methodology for sales other than sales
17 of tangible personal property that was in effect during
18 the years at issue. On this point, you will hear how the
19 vast majority of the activities related to the allowances
20 occurred in New York and also New Jersey, and to a lesser
21 extent, New Jersey.

22 You will hear about Liberty Procurement Company,
23 the Bed Bath & Beyond entity that was responsible for
24 managing the vendor relationships, negotiating the vendor
25 allowances, and performing under the various agreements

1 with regard to these allowances. From advertising to
2 promotional displays, even down to the layout of the
3 stores, all of the decisions were made in and directions
4 came out of New York and Liberty Procurement Co.

5 And you will hear about the limited role of the
6 in-store employees as far as their activities were
7 concerned related to vendor allowances and, basically,
8 what amounted to relief following instructions from back
9 East.

10 So to wrap up the opening here, we have two types
11 of receipts. And it's our position that both types are
12 properly includable in Bed Bath & Beyond's sales factor
13 denominator, but not in the numerators. They are properly
14 sourced outside of California.

15

16 PRESENTATION

17 MR. GUSTAFSON: And so now turning to the first
18 issue, that is, Your Honors, is we'll jump right into the
19 argument and more about the treasury receipt issue. So,
20 again, we have a statute that defines sales to mean all
21 gross receipts not allocated for the years at issue. It's
22 our position that the statute controls. As I mentioned,
23 FTB promulgated a regulation in 2008 under Revenue &
24 Taxation Code Section 25137.

25 So, specifically, this is the FTB Regulation

1 25137(b) (1) (d) that excludes treasury receipts from the
2 sales factor. This regulation was in effect -- or it was
3 promulgated in 2008, but it was in effect for tax years
4 beginning on or after January 1st, 2007, which covers the
5 tax years at issue. But, you know, despite this -- the
6 promulgation of this regulation, the statute controls.

7 As I mentioned in the brief opening, you have the
8 decision out of California Supreme Court Microsoft versus
9 Franchise Tax Board, which interpreted a definition of
10 sales as in particular, gross receipts to mean this full
11 amount received, all gross receipts. And, notably, that
12 case specifically involved treasury receipts, the same
13 receipts that are issued here.

14 And not only do we have the state high court
15 affirming inclusion of these receipts. The legislature
16 also did as well. The legislature confirmed that treasury
17 receipts were includable as sales during the years at
18 issue. How again -- and how do we know this? Well, the
19 legislature amended the statute in 2009 to exclude the
20 treasury receipts, but it made the changes not effective
21 until tax years beginning on or after January 1st, 2011.
22 And prior tax years were expressly under the old
23 definition. Again, all gross not allocated.

24 So here we have crystal-clear legislative intent
25 that sales for the years at issue includes all gross

1 receipts of the taxpayer, including treasury function
2 receipts. So there was, you know, the -- there's a few
3 indications of this legislative intent. One, the
4 legislature amended the statute after FTB's regulation was
5 already in effect.

6 So whether their regulation or not, the
7 legislature comes in and says, okay, we're taking a look
8 at this. And we're going to say, yes, these receipts are
9 no longer included in sales, but we're going to set the
10 date for this exclusion starting three years down the
11 road; tax years beginning on/or after January 1st, 2011.
12 And as noted in the legislative history, the purpose of
13 the legislation was to explicitly exclude treasury
14 receipts, per the Senate floor analyses.

15 So they were included, particularly as confirmed
16 by the Supreme Court in Microsoft. And as of 2009 when
17 this legislation was passed, they were still included and
18 the legislature says, okay, we are going to specifically
19 exclude them starting 2011. And, again, that's -- the
20 legislature could have made the amendment -- the amended
21 definition retroactive, but it didn't. So not only did it
22 not make it retroactive, it made it -- and it did. It
23 held off the effective date for another two years into the
24 future.

25 So, again, for 2009 and 2010, these receipts were

1 still included. And, again, it was part of this
2 amendment. The -- the legislature amended what -- you
3 know, 25120(e) to say for tax years beginning before
4 January 2011 sales means all gross receipts not
5 allocated -- the old definition. It said part of this
6 amendment it -- it just put it right there in black and
7 white for years beginning before January 1st, 2011
8 these -- the old definition applies. This exclusion for
9 treasury receipts does not apply.

10 In addition to the -- the California Supreme
11 Court and the California legislature, as noted in our
12 briefing, we also have the California Court of Appeal
13 interpreting the treasury function receipt issue in the
14 Decision of General Mills versus Franchise Tax Board,
15 which applied the pre-amendment definition that the case
16 was decided after the legislative amendment but was
17 looking at years before the amendment became is effective.

18 And it followed Microsoft saying that treasury
19 receipts are includable in the denominator and expressly
20 stated that such receipts are excluded only for years for
21 which the amendment is effective. So right -- years
22 beginning on or after January 1st, of 2011. So further
23 confirmation that the important date here under the
24 statute, for whether or not treasury receipts are
25 included, is January -- for tax years beginning January --

1 on or after January 1st, 2011.

2 So the FTB as an administrative agency does not
3 have the authority to usurp the will of the legislature
4 via regulation. And the regulation directly contravenes
5 the statutory provisions. And we have -- there are a
6 number of legal authority and citations speaking to the
7 limits of an administrative agency. For example, the
8 legislature may confer upon an agency the power to fill up
9 the details of a statutory scheme, but the administrative
10 agency may not substitute its judgement for that of a
11 legislature in a case, there is the Alcoholic Beverage
12 Control Appeals Board, and we're happy to provide cases
13 and citations in any post-hearing briefing that the panel
14 may require or ask for.

15 There's no agency discretion to promulgate a
16 regulation which is inconsistent with the governing
17 statute. And any administrative action that is not
18 authorized by or inconsistent with acts of the legislature
19 is void. And the case, there is Carmel Valley Fire versus
20 California. And similarly, administrative regulations
21 that alter, amend a statute, or in large or impair its
22 scope or void and are required to be struck down. That's
23 JR Norton Cove versus Agriculture Labor Relations Board.

24 But I think most importantly, the Microsoft Court
25 address this -- this very point. And if I may just quote

1 directly from pages 771, 772 of the Supreme Court's
2 opinion. We note the Court of Appeals' argument that
3 policy reasons favor systematic exclusion of the return of
4 capital from investment redemptions, rather than a
5 requirement that the Board document distortions resulting
6 from application of the standard formula on a case-by-case
7 basis.

8 All right. So instead of having to deal with
9 whether or not inclusion of treasury function receipts are
10 distortive because they're otherwise includable on a
11 case-by-case basis, there's a rationale to exclude them
12 entirely. And so the court continues, absent a global
13 redefinition of gross receipts to exclude such returns,
14 smaller distortions insufficient to trigger a reappraisal
15 under section 25137 may slip through the cracks resulting
16 in underestimation of the tax owed California.

17 This concern may well be valid. Recognizing this
18 problem, numerous other state legislatures have amended
19 their respective income apportionment statutes to
20 expressly exclude investment returns of capital from the
21 definition of gross receipts. And it continues -- and
22 I'll wrap with -- conclude the quote with this, amicus
23 curiae. The multistate tax commission has proposed model
24 regulations that likewise exclude investment returns of
25 capital from gross receipts.

1 The legislature is free to follow these leads.
2 In the absence of legislative action, however, we are not
3 free judicially to amend the UDITPA to achieve this
4 result. So here we have the California Supreme Court
5 saying, we get it. We hear you. There are potential
6 issues where you might have smaller amounts of these exact
7 same treasury receipts that come through that -- that may
8 not rise to a particular level of distortion, and you want
9 to deal with them all in one fell swoop.

10 We understand. That makes sense. We've seen
11 other state legislatures do that. And we even have
12 proposed regulations from -- model regulations from the
13 Multistate Tax Commission. But we, the California Supreme
14 Court, are waiting for the state legislature to act.
15 That's what we're waiting for. The legislature is free to
16 follow these leads. The absence of legislative action,
17 the court is not freely judicially to amendment UDITPA to
18 achieve this result.

19 And that's exactly what FTB has done. So FTB,
20 much like the California Supreme Court, doesn't have the
21 authority to amend UDITPA to achieve the same result.
22 It's up to the state legislature, and that's what the
23 state legislature did in 2009. It amended the statute
24 following this. It's like the court laid out the road map
25 and the legislature walked right down it and say, okay.

1 We hear you California Supreme Court. We are going to
2 amend our statute to exclude treasury receipts, and that's
3 what we did. And that's what the legislature did, and
4 they did it with a date in mind; a specific date, Jan --
5 tax years beginning on/or after January 1st, 2011.

6 So the fact there's -- it's a clear pronouncement
7 by the high state court and the legislature that these
8 receipts are includable. The Franchise Tax Board's
9 authority is limited. It cannot do what the California
10 Supreme Court won't do with regard to contravening the
11 will of the legislature or take -- usurping the power of
12 the legislature. It has its own authority, but that
13 authority is limited. And in one way it's limited in that
14 it's up to the legislature to amend the statute. And
15 that's what it ultimately did.

16 I think -- and even -- so that's our position is
17 that the statute controls and the receipts come in. But
18 even if FTB's regulation applies there's a couple of
19 points worth mentioning here. The first one -- and this
20 is something for the panel to consider -- is that the
21 regulation itself does not contain a quantitative
22 distortion component related to treasury receipts. The
23 California courts have held that the distortion statute,
24 Revenue & Taxation Code Section 25137 applies where there
25 is both quantitative distortion and qualitative

1 distortion.

2 All right. So from the decision of General
3 Mills, the panel knows that there were two decisions --
4 General Mills decisions. The first one, General Mills
5 won, was interpreting Microsoft and saying an alternative
6 formula could be imposed under Section 25137 if the
7 challenged activity both qualitatively differs from the
8 taxpayer's principal business and quantitatively distorts
9 the formula by a substantial amount.

10 So FTB's regulation seeks to exclude treasury
11 receipts based on a qualitative distinction alone, you
12 know, improperly omitting quantitative factors. So even
13 if it's just \$1, the treasury receipt is excluded. So
14 that's one thing to consider about FTB's regulation.

15 And the second -- the second thing to consider
16 about the regulation is if applying it to here is what
17 itself results in distortion. The case in Microsoft and
18 General Mills, the ultimate question was whether or not
19 inclusion over the receipts, these treasury function
20 receipts, didn't fairly represent the taxpayer's
21 activities in the State of California. Did they
22 distort -- would create distortion and permissible
23 distortion.

24 And here inclusion of the treasury receipts on
25 average, across the years at issue, makes up just 5

1 percent of the taxpayer's gross receipts. Those -- that's
2 not distortive, and the taxpayer's apportionment factor
3 fairly represents its activities in the state. And you
4 can compare that with the facts in Microsoft where the
5 treasury receipts made up 73 percent of Microsoft's total
6 gross receipts in General Mills. There the treasury
7 receipts made up about on average 19 percent between 8 and
8 30 percent, depending on the multiple years -- the various
9 years at issue in that case.

10 And here, again, on average we have a difference
11 of 5 percent. So it wouldn't rise to the level of
12 impermissible distortion. So as a consequence, again, if
13 the FTB gets by the statutory argument, which we don't --
14 which we think ends the discussion and if the regulation
15 applies, it's -- the application creates distortion. And
16 so that's the Board of Equalization decision in Appeal of
17 Fluor is satisfied because that's the decision that held
18 that once the criteria of distortion regulation are met,
19 the regulation applies and is the burden of the party
20 seeking deviation from the regulation to prove that
21 application creates distortion.

22 And so under our facts, Fluor satisfied. Even if
23 FTB's regulation applies, even if it is consistent with
24 the California court's interpretation of Section 25137,
25 the receipts still come in. So again, there's no end

1 around available to FTB via regulation -- under 25137 or
2 otherwise, because we have the legislature and the State's
3 high court saying these receipts are includable in the
4 sales factors for these years.

5 Turning now to Issue Two and the vendor allowance
6 issue. I'll -- we're going to be introducing the subject
7 and then ultimately just handing it over to my colleague
8 Mr. Tresh to enter in witness testimony. But just to
9 start off with regard to, you know, the question of
10 whether or not these vendor allowances, like the treasury
11 function receipts are includable in the sales factor,
12 maybe a little context about industry practice.

13 So these vendor allowances generate hundreds of
14 billions of dollars for retailers every year. And result
15 from the ability of these retailers, like Bed Bath &
16 Beyond, to negotiate the amount and type of allowance they
17 receive and services that they provide to the vendors to
18 compete in this increasingly competitive consumer goods
19 industry that Bed Bath & Beyond negotiates a whole bunch
20 of different allowances with its vendors. Each contract
21 is negotiated independently. No two contracts are
22 necessarily the same.

23 And Bed Bath & Beyond not only does it negotiate
24 the allowances, it negotiates the services -- the
25 corresponding services and benefits that it provides to

1 the vendors. So our primary argument is similar to the
2 first issue, is that the statute controls under Revenue &
3 Tax Code Section 25120(e), sales means all gross receipts.
4 Under the Supreme Court's decision in Microsoft, gross is
5 the whole amount received.

6 So we have our -- we have receipts, and we
7 include the whole amount. And so the default position is
8 coming into the sales factor for the years at issue. For
9 purposes of this appeal and for administrative
10 convenience, we have specifically focused on five
11 categories of receipts. We've identified these in our
12 briefing, and these categories have, in fact, the highest
13 amount of receipts involved for the years at issue. And
14 the five categories are markdown reimbursement, vendor
15 rebates, supply chain or distribution charges, vendor
16 compliance fees, and cooperative advertising allowances.

17 And, you know, we have addressed these in our
18 briefing, but we're going to explore them further today
19 with Mr. Taplits. And you'll hear from Mr. Taplits how
20 each type of allowance generates receipts to Bed
21 Bath & Beyond. Mr. Taplits is going to explain how Bed
22 Bath & Beyond provides benefits, both tangible and
23 intangible in exchange for the receipts -- exchange for
24 these receipts these payments from the vendors. And the
25 tangible benefits include such things like product

1 placement, in-store promotion, and intangible benefits,
2 like overall marketplace exposure.

3 When Bed Bath & Beyond carries a vendor's
4 product, other retailers see it and take notice and often
5 start carrying the product too because of Bed Bath &
6 Beyond's influence in the industry. I mean, once you get
7 that Bed Bath & Beyond's seal of approval, it carries
8 great weight. And that adds huge benefits to Bed Bath &
9 Beyond's vendors. In addition to these benefits, Bed Bath
10 & Beyond provides -- performs services in exchange for the
11 vendor allowance payments.

12 These services include providing store space --
13 designated store space, favorable product placement,
14 promoting and advertising a vendor's product by using
15 marketing and promotional materials, print and digital
16 advertising. I know we have all received the mailings,
17 the rectangular blue and white mailings with the coupons.
18 You have all seen those and used those. Bed Bath & Beyond
19 also provides signs and displays for specific products.
20 And they also provide -- performs market research,
21 providing data to vendors covering sales, inventory by
22 location on a regular basis.

23 And it's on this last point you will hear from
24 Mr. Taplits how vendors -- you know, they could obtain
25 market research from third-party vendors. But they buy it

1 from Bed Bath & Beyond because, frankly, Bed
2 Bath & Beyond's information is better. Their data -- the
3 data analytics is better. And why is that? Well, it's
4 because of the insight and the intimate knowledge that Bed
5 Bath & Beyond has of that vendor's products and the
6 relationship they have from the agreements in place. And
7 in addition to the data analytics, similarly, the
8 advertising that Bed Bath & Beyond provides is similar to
9 what a third party could provide.

10 Another point that I will discuss with
11 Mr. Taplits is the contracts themselves that Bed Bath &
12 Beyond has with its vendors state how the company is
13 eligible to earn certain allowances. Now, that language
14 is consistent with Bed Bath & Beyond's position that these
15 allowances once earned are receipts includable in the
16 sales factor. And the payments -- these payments, these
17 vendor allowance receipts are included in Bed
18 Bath & Beyond's books and records and reported its public
19 filings. And Mr. Taplits is going to walk through some
20 examples there.

21 And turning now to the sourcing question. The
22 preponderance of income producing activities related to
23 these vendor allowances is outside of California based on
24 cost of performance. Mr. Taplits will discuss Liberty
25 Procurement Company. It's an entity that was based in New

1 York until 2012 when it moved to New Jersey. He'll talk
2 about how Liberty was the Bed Bath & Beyond entity
3 responsible for managing vendor relationships, negotiating
4 vendors allowances, and performing the activities
5 associated with services and benefits Bed Bath & Beyond
6 provided in exchange for the allowances.

7 Liberty's employees were located in New York
8 during the years at issue. It had no offices or employees
9 in California. Mr. Taplits is going to discuss this in
10 more detail, but Liberty determines the store product
11 placement. It determined the end-cap displays, those
12 prominent displays at the end of the store aisles. That
13 was determined back in -- back East, not in the California
14 store. Checkout displays, product promotion displays,
15 marketing, advertising, Liberty was the entity that was
16 developing and coordinating the advertising, generally,
17 and promotion for the vendors.

18 They created video signage. They designated
19 product fixtures, register placement. And they even
20 planned -- Liberty even planned the physical layout and
21 designed the store, including where products are placed on
22 shelves. And all this was Liberty. It had taken place in
23 New York by Liberty employees. Now, in contrast, the
24 in-store employees' activities related to vendor
25 allowances is amounted to following Liberty's

1 instructions. So any cost incurred to hang signs or
2 install in-store promotion or displays at a retail
3 location is minimal.

4 And at this point, I'm going to turn it over my
5 colleague, Eric Tresh, who will be handling the testimony
6 of Mr. Taplits.

7 MR. TRESH: Thank you, Tim.

8 And good morning, Your Honors.

9 I'd like to call Mr. Steven Taplits, Bed
10 Bath & Beyond's Vice President of Tax, to the stand.

11 JUDGE LEUNG: Thank you. Mr. Tresh, before you
12 go on --

13 Mr. Taplits, I need to swear you in. So if you
14 could please raise your right hand.

15

16

STEVEN TAPLITS,

17 produced as a witness, and having been first duly sworn by
18 the Administrative Law Judge, was examined and testified
19 as follows:

20

21 JUDGE LEUNG: Thank you. Please state your name
22 for the record.

23 THE WITNESS: My name is Steven Taplits.

24 JUDGE LEUNG: Thank you, sir.

25 Mr. Tresh, please continue.

1 A Yes, I do.

2 Q Mr. Taplits, are you aware that this case relates
3 to the fiscal years 2009, 2010, and 2011?

4 A Fiscal end of those years, yes.

5 Q Okay. And during those times, from your time
6 joining the company in 2010, your responsibilities remain
7 constant since from the start of the time you joined the
8 company?

9 A Yes.

10 Q Okay. Mr. Taplits, can you tell the Court how
11 you came to be familiar with the issues in this case?

12 A Well, it's actually a long history. I used to be
13 the Vice President of Taxes at Bed Bath -- at Home Depot.
14 And there was an issue of the treasury securities being in
15 the denominator of the apportionment factor there. And I
16 was dealing with a law firm. Apologies, but it was not
17 your law firm, Eric.

18 And we ended up taking the case to the Board of
19 Equalization, and we actually won the case because we
20 didn't have distortion and they included the treasury
21 security receipts in the denominator of the apportionment
22 factor for those years. And then what happened subsequent
23 to that, the Franchise Tax Board came out with a deal that
24 they were settling with any company that had the treasury
25 receipts in the denominator, depending on the level of

1 distortion.

2 So when I got to Bed Bath, I checked to see at
3 some point -- it was after the returns were filed, but at
4 some point I asked if we were including treasury receipts
5 in the denominator, and the answer was no. And I said,
6 well, we should probably amend those returns. And I --
7 then we did. We did so, and we ended up settling with the
8 Franchise Tax Board those years, 2000 -- maybe '06 or
9 something like that. 2007 or 2005, I don't remember which
10 years.

11 And, you know, based on the program that the
12 Franchise Tax Board put together, I mean, there was no
13 need to litigate the issue again. It didn't make any
14 sense. So then some period of time later -- and I
15 honestly don't remember if it was a year or two years --
16 either I called the attorney that handled this for me
17 originally at Home Depot or he called me, and we started
18 talking about whether or not we should do the same thing
19 for fiscal year end 2009, '10, '11.

20 And we had this discussion that the statute was
21 not effective until -- in January -- after January --
22 years beginning after January 1st, 2011, and the years
23 that we were dealing with were before that. So it sounded
24 like a reasonable thing to do and to properly file the tax
25 returns, including what we were entitled to put in the

1 denominator. So we did that, but the same -- at about
2 that time -- actually, it was probably the same call --
3 the attorney asked me, "Well, is there anything else that
4 you're aware of that are receipts that the company might
5 not be putting in the denominator?"

6 You know, I actually thought for not that long,
7 and I said, "Honestly, the only thing I could think of
8 would be vendor allowances." And he said, "Well, tell me
9 about it?" And I told him about the vendor allowances and
10 what they are, what I knew at that time. And he said,
11 "Well, I think, you know, you should find out more about
12 it." And we did.

13 We found out more about it, and he believes --
14 the attorney believed and convinced me, and I convinced
15 upper management that we should amend the returns for
16 fiscal year ending February 2009, '10, and '11 to include
17 the vendor allowances in addition to the treasury
18 receipts. So we did. And, you know, that's -- that's the
19 extent of what happened.

20 Q Thank you, Mr. Taplits. And, Mr. Taplits, so
21 keying off those -- that conversation you had on the
22 vendor allowances, so the lawyer comes to you and he
23 says -- well, you say to the lawyer, hey, we might
24 consider including vendor allowances. The lawyer says,
25 hey, we should do some more diligence. Tell me about

1 that. And so did you learn more about the vendor
2 allowances at that time? Did you become familiar with
3 them?

4 A I became as familiar as I thought I needed to be.
5 I spoke to -- in particular, I spoke to one of the vice
6 presidents that was in charge of merchandising or buying.
7 I don't remember what his title was, but I did know him
8 for, like, nine years. He's not with the company anymore.
9 That was David Denenberg, and he explained it to us. And
10 I conveyed that to the attorney and, you know, we had that
11 conversation and decided to include it in the denominator.

12 Q And Mr. Denenberg has submitted an affidavit in
13 this case. Are you aware of that?

14 A Yes, I am.

15 Q Okay. And Mr. Denenberg has since left the
16 company and is no longer with the company; is that
17 correct?

18 A Unfortunately, yes.

19 Q Okay. And so, Mr. Taplits, can you tell the
20 Court what are vendor allowances? Is it really an
21 allowance, or is it a receipt? What is a vendor
22 allowance?

23 A It's monies that we receive for doing certain
24 services, both tangible or intangible, for the vendors.
25 My personal belief -- and I think it's logical -- that

1 nobody does something -- nobody gives you anything for
2 nothing. So if we're going to receive vendor allowances,
3 we're doing something for it. Nobody just does it. And I
4 believe we received it for the services we perform,
5 whether it's tangible or intangible. I believe we are,
6 yeah.

7 Q And Mr. Taplits, what are some of those services
8 that you perform in exchange for the vendor allowances?

9 A You know, I mean, as an example, I guess we --
10 from markdown reimbursements as an example, I mean, we
11 don't even have to necessarily, you know, markdown
12 products if we don't want to. But, you know, what happens
13 if a vendor is coming out with a new product and want to
14 get their old product out of the store and only have the
15 new product in the store?

16 And so we'll, you know, we might mark it down.
17 We're doing that service for the company, so the product
18 can be sold. If we mark it down too much so that we can
19 really get it out of the store, we expect the vendor will
20 compensate us for that differential. But our services
21 is -- is, you know, we're helping the vendor get the
22 product out of the store. I mean, just as an example.

23 Q And I'll ask some more direct questions in that
24 regard. But before I do that, Mr. Taplits, is it your
25 understanding that Bed Bath & Beyond negotiates these

1 vendor allowances -- we're going to talk about the
2 specific categories in a moment -- but that you negotiate
3 these vendor allowances with a significant number of your
4 vendors?

5 A To some extent I'm sure we negotiate vendor
6 allowances with all vendors. There's no reason to not
7 negotiate them. If you're going to do business with
8 somebody, you're going to negotiate. Now, depending on
9 the power of the parties, some vendor allowances will be
10 greater than others or different from others. You know,
11 but there's a system in place that is used, and the
12 buyers, you know, try to follow the system.

13 Q Yeah. So, Mr. Taplits, for purposes of our
14 appeal today and for the Court's benefit, we've identified
15 five main categories of vendor allowances that we're going
16 to discuss with you in a moment. Those five categories
17 are markdown reimbursements, vendor rebates, supply chain
18 or distribution charges, vendor compliance fees, and
19 cooperative advertising.

20 Mr. Taplits, is it your understanding that each
21 one of those categories that I just read falls broadly
22 within the category of vendor allowances as we're talking
23 about them?

24 A Yes.

25 Q Okay. So I'd like to start with the markdown

1 reimbursement. You just described what a markdown
2 reimbursement is where the company marks down a product to
3 move inventory for the benefit of a vendor; is that right?

4 A Well, it's a benefit for the vendor. It also, at
5 times, depending on the markdown will be to our benefit
6 too. We want to sell product too. But it's certainly
7 many times a benefit to the vendors.

8 Q Does the company provide data analytics to its
9 vendors as part of the markdown reimbursement services?

10 A Yeah, of course. For all services there's data
11 analytics. I mean, we have a robust IT system and data
12 collection system on the products that are sold and the
13 products that are sold ancillary to the products that are
14 sold.

15 Q And so part of the reason why the company gets
16 paid for markdown reimbursements, like its receipts, it is
17 because the vendor is being provided with a robust set of
18 data analytics; is that accurate?

19 A Well, that's one of the reasons. Yes.
20 There's -- like I said, there are reasons. I gave another
21 example just to move product as an example, but yes.

22 Q Okay. And, Mr. Taplits, in your view are
23 markdown reimbursements receipts to the company?

24 A Yeah. Absolutely.

25 Q Okay. Mr. Taplits, are you familiar with the

1 term "vendor rebates?"

2 A It's the company. There's monies coming in to
3 the company, so I can -- so it's a receipt, you know.

4 Q Mr. Taplits, are you familiar with the term
5 "vendor rebates?"

6 A Yeah.

7 Q What is a vendor rebate?

8 A If -- let's say there's various levels of sales
9 that we achieve for a vendor, we receive vendor money for
10 the level of sales that we achieve.

11 Q Okay. In the course to earn those vendor
12 rebates, what are some of the things that Best Buy might
13 do?

14 A You know, you said Best Buy.

15 Q Best Buy. Bed Bath & Beyond. I'm sorry. Maybe
16 a case for another day. Bed Bath & Beyond. I'm sorry,
17 Mr. Taplits.

18 A I mean, I can just, I guess, give examples. You
19 had mentioned our -- no, Tim had mentioned our procurement
20 company. It used to be called Bed Bath & Beyond
21 Procurement Co. Inc. It moved to New Jersey in 2012, and
22 we changed the name to Liberty Procurement Co. Inc.
23 because it's on Liberty Avenue. So we changed the name.

24 I think at the time that -- during the years at
25 issue right now, I think that company had maybe over 400

1 people working for it. I think it may have over 800
2 people now. But, you know, one of the things it does is
3 it plans store layouts, the end caps, where products are
4 place. And we do it in order to drive sales for vendors.

5 And I'm sure they take into account, okay, where
6 are we getting the most benefit for our buck? So we'll do
7 it more for vendors that are giving us either vendor
8 rebates or larger vendor rebates. It's logical to do that
9 to drive the right business.

10 Q And, Mr. Taplits, that planning, the end caps and
11 where the store -- planning on how it's all laid out and
12 the data analytics associated with that, that's performed
13 by those hundreds of people that were in New York and now
14 are in New Jersey; is that correct?

15 A Well, some portion of the hundreds of people that
16 were in New York and are now in New Jersey. You know,
17 they do a lot of other things too. They're different
18 people.

19 Q Okay. And, Mr. Taplits, are vendor rebates
20 receipts to the company in your view?

21 A Yes.

22 Q Okay. Mr. Taplits, are you familiar with supply
23 chain charges?

24 A Yes.

25 Q And what are supply chain charges?

1 A We receive a rebate from -- we receive monies
2 from the customer -- from the vendor if the freight that
3 we've -- of course that we've agreed to pay, exceed a
4 certain threshold.

5 Q Okay. And in your view are the supply chain
6 charges receipts to the company?

7 A Yes.

8 Q Mr. Taplits, are you familiar with vendor
9 compliance fees?

10 A Yes.

11 Q Okay. Can you tell the Court what vendor
12 compliance fees are?

13 A You know, it's really interesting. I was
14 thinking more about that the other day. The first time I
15 ever heard about that was when Walmart instituted it.
16 Okay. So I guess we probably followed Walmart. I mean,
17 I've been in the retail business since '78 -- '83 -- 1983.
18 So a long time. So I've seen quite a bit. And the vendor
19 compliances is if a vendor, you know, ships something
20 late, or doesn't pack it right, or if they, you know, do
21 something they shouldn't do, you know, they owe us money.

22 And we usually supply them data so that they know
23 exactly what they've done wrong and why so that they know
24 not to do it again, you know, or that they reduce their
25 noncompliance. So, you know, we try to work with the

1 vendor.

2 Q Okay.

3 A I mean, we want -- we want the product in the
4 store, obviously, and we want it when we want it, and we
5 want it how we want it. So --

6 Q And, Mr. Taplits, these data -- the data that you
7 supplied to the vendors that we've talked about in each of
8 these categories of vendor allowances, is that data
9 provided using I.T. infrastructure that Bed Bath & Beyond
10 owns?

11 A Yes.

12 Q And where is that I.T. infrastructure located?

13 A That specific I.T. infrastructure was probably in
14 New Jersey at the time, the I.T., actually, servers and
15 stuff like that. But they were utilized by the New York
16 people in order to compile the information, the format
17 that was necessary.

18 Q So the I.T. infrastructure was in New Jersey and
19 used by people in New York or New Jersey?

20 A Correct.

21 Q And, Mr. Taplits, are you familiar with
22 cooperative advertising allowances?

23 A Yes.

24 Q What are cooperative advertising allowances?

25 A As an -- I can give examples. Let's say we're

1 sending flyers out to customers. In the flyer we may push
2 a product -- a particular product. You know, an
3 eight-page flyer or whatever it is could cost a lot of
4 money to print. And by the way, it's all -- it's printed
5 outside of California or in the paper bought outside of
6 California. But there's a large cost to those, the
7 mailings, the postage, and everything else, which is also
8 posted outside of California. We have a firm that handles
9 that for us.

10 There was actually a recent court case in
11 Michigan that shows that. That actually went up the Court
12 of Appeals that we won at the Court of Appeals level. So
13 if we're going to be pushing a vendor's product, we expect
14 them to share in the cost. Plus, there's probably a
15 markup, I'm sure, and that's what that is. It's vendor
16 allowances that they pay us money for it, for the
17 advertising that we're doing for them. And I'm sure -- I
18 mean, back in those days I don't think we did TV
19 advertising or radio advertising. Probably a little but,
20 you know, we did that too. So it depends on how much we
21 advertise for them.

22 Q And, Mr. Taplits, would an example of the
23 advertising be a big coupon that's sent in the mail, for
24 example, somebody might receive? Would that be an example
25 of advertising?

1 A It's possible that there is some vendor
2 information on some of those coupons, but I'm really not
3 certain that the coupons had vendor information --
4 specific vendor information. I haven't really looked at
5 them in so many years, and I don't recall back then if
6 that was the case. It's possible, but I -- I don't want
7 to testify to it.

8 Q Okay. And, Mr. Taplits, can you tell the court
9 what are some of the -- you mentioned there were tangible
10 and intangible benefits associated with the provision of
11 services under the general vendor allowance nomenclature.
12 What are some of the intangible benefits that a vendor
13 receives by paying Best Buy for the vendor reimbursements?

14 A Bed Bath.

15 Q Oh, my god. I'm so sorry. Bed Bath & Beyond.
16 Excuse me. What are some of the intangible benefits that
17 Bed Bath & Beyond receives?

18 A Later I'll tell you a funny story. But,
19 actually, the one example -- it's a real interesting
20 example that comes to mind because I actually found out on
21 my own. I don't think anybody -- you know, it's like
22 David Denenberg didn't tell me this. I found out just in
23 general conversations with people. I don't remember if
24 you recall when SodaStream first came to market.
25 SodaStream is an Israeli company, and it first came to

1 market, and we received -- this is what I was told. Okay.
2 So I'm just conveying what I was told, and I believe it to
3 be true.

4 We received an exclusive for a period of time to
5 have their product in our stores, and we pushed their
6 product hard. And SodaStream, you know, it's where they
7 have the carbon dioxide that goes into the water, and it
8 creates like a club soda seltzer with flavors and stuff
9 like that. So I think -- I think we had that exclusive
10 possibly for six months, but I'm not sure how long.

11 And other retailers -- you know, talk about the
12 intangible benefit -- other retailers, you know, they saw
13 us having this product and it was a boom for SodaStream.
14 I mean, once, you know, the exclusive period was over,
15 they started doing business all over the country and other
16 retailers. And they became a very successful company. I
17 remember their stock price I think went sky high.

18 So, you know, if -- I guess if -- if other
19 retailers see that Bed Bath is buying something and
20 pushing something, they want to do it too. And that's a
21 big intangible benefit to a vendor. And it's not just
22 SodaStream. It's happened elsewhere.

23 Q So that would be an example of why a vendor like
24 SodaStream would pay Bed Bath & Beyond or these vendor
25 allowances; is that correct?

1 A That is correct.

2 Q Okay. So, Mr. Taplits, I'm talking about some
3 other benefits. You've mentioned that markdown
4 reimbursements help prevent the return of unsold
5 merchandise; is that correct?

6 A Well, I don't think I said it that way. What I
7 said is that markdown reimbursements help the vendor get
8 old product out of the store, and if it's marked down past
9 the point where we're going to eat the markdown, then we
10 get a markdown reimbursement. And it's for the benefit of
11 not only us but also for the vendor because, you know,
12 they want to bring, you know, new products to customers.
13 I mean, customers don't just want to keep buying the same
14 old product. In many cases, if you don't showcase new
15 products, your sales are going to decrease.

16 Q Mr. Taplits, is it the company's experience that
17 the vendor allowances help to increase vendors' revenue?

18 A It helps to increase vendors' revenue, and it
19 helps to increase our revenue. Yes.

20 Q And would they help to increase vendors' market
21 share, in your SodaStream example for it?

22 A It should. I mean, it depends on the vendor.
23 You know, I don't think it necessarily always happens
24 because it depends on the market also.

25 Q So can the vendor allowances help increase a

1 vendor's profitability?

2 A Yes, it can, if they -- as an example, if they're
3 able to bring newer product into the store with a higher
4 margin that they could sell to us.

5 Q And can the vendor allowances help to increase or
6 help the ability of vendors to sell to other retailers?
7 Is that a possible benefit of a vendor allowance?

8 A To sell to other retailers? I'm not following the
9 question.

10 Q So SodaStream for example. When SodaStream was
11 paying Bed Bath & Beyond for vendor allowances the
12 visibility helped to get it into other retailers; correct?

13 A That's a correct statement.

14 Q Okay. And all of those different services is it
15 your experience, the company's experience, that vendors
16 are willing to pay Bed Bath & Beyond for those tangible
17 and intangible benefits?

18 A Absolutely. As I said when I first started this,
19 nobody gives you some money for doing nothing. You have
20 to be doing something for them. And I, you know, outlined
21 a few items of the items that I believe we're doing for
22 vendors.

23 Q Mr. Taplits, we talked a little bit about the
24 data analytics that the company provides. I'm going to
25 drill into some examples of what information those data

1 analytics might have. So, for example, would the data
2 analytics help tell a vendor where their products should
3 be located in a store? Would that be one example of data
4 analytics?

5 A Well, I mean, I can give you an example, you
6 know. Let's say that we sell luggage, to give as an
7 example. Let's say we sell luggage. And how data
8 analytics show that people that buy luggage -- this is
9 before the iPhone, by the way. Because once you get the
10 iPhone you don't need the product, I'm about to tell you
11 about. That people that buys luggage will also buy these
12 travel alarm clocks because they need to wake up, but you
13 don't need it anymore.

14 And I never liked to wait for a phone call from
15 the hotel. But people buy these alarm clocks. So we were
16 able to tell the vendor, as an example, that if we sell
17 your luggage product, they were also buying alarm clocks.
18 So we go to the alarm clock vendor and we say, okay, we
19 should put it by the luggage besides putting it in the
20 clock area. So the data analytics helps the clock
21 company, you know.

22 Q And it would have been the team in New York and
23 New Jersey using that I.T. infrastructure that was coming
24 up and would be able to say customers that buy luggage
25 might also buy more alarm clocks, let's put them together

1 in the same placement?

2 A I mean we have probably over a million SKUs of
3 products that we're selling. And yeah, it has to be done
4 with technology and systematically and through I.T. You
5 can't just do it off the cuff.

6 Q And then that strategy would have been
7 disseminated down to the stores. In other words, the
8 folks in New York and New Jersey with their I.T.
9 infrastructure would then tell people in the stores around
10 the country, put the alarm clocks next to the luggage?

11 A That is correct.

12 Q Is that fair?

13 A Yeah, they give stores instructions. I don't
14 know how often that happens, but they give the stores
15 instructions on how to -- where to put it on the shelves
16 and stuff like that and pricing and everything else.

17 Q In theory could those data analytics could --
18 maybe they wouldn't be as good, but could you buy data
19 analytics from a third-party company? Could your vendors
20 have chosen not to get them from you and gotten the data
21 analytics from somebody else?

22 A And they probably do both for what they sell in
23 our stores and what they sell to other retailers, but it
24 seems to me -- let me strike that.

25 It makes sense that if we have the specific data

1 for our stores, the vendors are going to want the best
2 data for our stores. If you go to a third party, although
3 you can buy that information, you don't necessarily know,
4 you know, where the data is really coming from. For us
5 you know the data is come from firsthand knowledge of what
6 products are being sold in our stores.

7 Q So Bed Bath & Beyond built a better mouse trap,
8 so to speak, and that's why companies paid for its data in
9 this regard; is that fair?

10 A For our stores. For our stores, yes.

11 Q Okay. And could the same be said of advertising?
12 In other words, vendors could buy advertising from lots of
13 different marketing companies I would imagine. Is that
14 your experience given your background in retail? I can
15 buy advertising services from many people; right?

16 A It's a lot. Yeah, but it's very costly for them
17 to do it on their own. It's a lot easier just to go on
18 the back of a Bed Bath flier or something else that Bed
19 Bath is doing and -- and they're sharing the cost plus,
20 you know, maybe some markup. It would -- it's a lot less
21 costly for them.

22 Q So one of the reasons that your vendors would buy
23 a cooperative advertising -- pay you for the cooperative
24 advertising at issue in this case is because the type of
25 advertising you could do would be better than that they

1 could receive from a third party; is that fair?

2 A Plus they want us to drive their sales, and we
3 are driving their sales. They're benefiting. We're
4 earning the money that they're paying us because we're
5 driving their sales.

6 Q Okay. Mr. Taplits, are you familiar with how the
7 vendors pay the allowances to Bed Bath & Beyond?

8 A Yes.

9 Q And are you familiar with how Bed Bath & Beyond
10 identifies and records these allowances in its records?

11 A Yes.

12 Q Okay. Can you tell the Court a little bit of how
13 that works? How do you receive the money, and how do you
14 record it in your records? Can you identify it?

15 A Yeah. There's a system called the AMS System. I
16 don't recall what it stands for. But it identifies all of
17 the different allowances that are negotiated by Liberty
18 Procurement Company employees, and it goes vendor by
19 vendor. It details them all. The -- what was the --

20 Q And in that follow-up question -- thank you,
21 Mr. Taplits. Follow-up question, so this AMS System that
22 you mentioned, does it allow Bed Bath & Beyond to track
23 the vendor allowance payments internally?

24 A Yes, internally. And the way the vendor pays us
25 is they -- there's a credit that goes against the accounts

1 payable that we have. There's probably very little that's
2 actually sent by check or wire. So if we owe them money,
3 the credit comes in through AMS into whatever system there
4 is to track the accounts payable. I guess that's in the
5 purchase journal.

6 Q So to provide an example, Mr. Taplits, let's say
7 SodaStream, if there was an accounts payable for
8 SodaStream for \$100, and SodaStream agreed to pay Bed
9 Bath & Beyond for a vendor allowance for data analytics or
10 cooperative advertising, accounts payable of \$100 could be
11 reduced by \$1.00, or \$10.00, or \$20.00, but you would
12 reduce it. The way you would receive that money is by,
13 you would offset against the accounts payable; correct?

14 A Correct.

15 Q Mr. Taplits, these agreements whereby the vendors
16 would pay you for these allowances, were they typically
17 documented in contracts for the vendors?

18 A Yes.

19 Q Okay. And did Bed Bath & Beyond have a standard
20 contract with its vendors?

21 A Well, it's somewhat standard. But, I mean,
22 depending on the strength of the vendor, it's going to be
23 changed through negotiations, sometimes significantly and
24 sometimes not at all. It depends on the vendor.

25 Q So a startup company like SodaStream might have

1 different allowances than a Proctor & Gamble might pay to
2 the company, perhaps?

3 A I don't want to speculate, but that would be my
4 guess. But I don't really want to speculate how it would
5 work out, and who would do what.

6 Q And these allowances that you track in the AMS
7 System, you mentioned at the outset of your testimony that
8 you thought they should be included in the denominator of
9 your California sales tax -- California sales factor --
10 California sales apportionment factor, did the company do
11 that? Did you include the vendor allowances that were
12 tracked in the AMS System in the California -- amended
13 California income tax return denominator?

14 A In the amended ones, yes. Now, keep in mind I
15 wasn't employed when they filed the original returns for
16 the -- probably the first year, fiscal year ending
17 February 2009. The second year, if I came in October, the
18 return was due in December. So I didn't make any changes
19 for February 2010, and I probably didn't even have the
20 conversation with counsel regarding the issue until after
21 the February 2011 was filed. I might have been thinking
22 of it. I don't even recall the timeline.

23 Q But the reason why --

24 JUDGE LE: I'm sorry. Just one moment.

25 MR. TRESH: Sure.

1 JUDGE LE: We are now at like the 30-minute mark
2 allowed for the witness testimony. I think we can go
3 ahead and allow a few more minutes to allow you to wrap
4 this up, if that's okay.

5 MR. TRESH: Yes. Thank you. Thank you,
6 Judge Le.

7 BY MR. TRESH:

8 Q If I can jump, I'm going to ask you to pull up
9 and look at Exhibit 9. Now, we're not going to put this
10 on the screen. This is one of the exhibits that has been
11 deemed confidential. If we can just turn to Exhibit 9,
12 please, for members of the panel?

13 A I don't -- I don't -- I have to take out the book
14 and see if I can find it. Okay.

15 Q Yup. It won't be going on the screen.

16 A Yeah. Okay. And I don't have where you
17 highlight it either. I only have the original exhibit
18 line. Okay. I have it, but I don't have any highlights.

19 Q That's okay. Mr. Taplits, this is a contract
20 between a subsidiary or an affiliate of Bed Bath & Beyond
21 and one of its vendors; correct? That's what we're
22 looking at in Exhibit 9?

23 A Yeah. Let me just -- yes. Exhibit 9, yes.

24 Q Okay. And this is a contract that talks about
25 how much money Bed Bath & Beyond can earn from the vendor

1 allowances; correct?

2 A Correct.

3 Q Okay. Mr. Taplits, does -- if I look under,
4 there's a line item on page 2 of the contract and it says,
5 "Co-op advertising allowances?"

6 A Okay.

7 Q Do you see that on page 2 of the contract?

8 A I see it.

9 Q And does this say best -- the affiliate of the
10 company is eligible to earn a cooperative advertising
11 allowance?

12 A Yes. Yeah. Yes.

13 Q And with respect to the other contracts that have
14 been put into evidence in this case, do they also say that
15 the company earns its vendor allowances?

16 A Hold on and let me look. Yes. Exhibit 10, yes.
17 I mean --

18 MR. TRESH: Judge Le, we'll be concluding in a
19 moment.

20 MR. TAPLITS: I mean, I have to look at
21 Exhibit 11 and go through it to see what's in there. But,
22 I mean, if we're having -- if we're going to have an
23 advertising allowance, we're going to say that it is
24 earned. Yes.

25 BY MR. TRESH:

1 Q And so, Mr. Taplits, is the concept that Bed
2 Bath & Beyond earns these receipts as set forth in its
3 contracts, is that consistent with the treatment of
4 including them in your California sales factor
5 denominator?

6 A Yes.

7 Q Okay. Thank you, Mr. Taplits.

8 MR. TRESH: Thank you, Judges for indulging a few
9 more questions. That concludes our testimony.

10 JUDGE LEUNG: Thank you, gentleman.

11 Mr. Tresh, do I understand you to say that your
12 presentation is complete?

13 MR. TRESH: It is, Judge. Thank you.

14 JUDGE LEUNG: Okay. So we'll go -- let's see.
15 It's approximately -- hang on. I think we can go to -- we
16 either take a break now or go to questions from the
17 Franchise Tax Board. I think our -- let's see.

18 The Franchise Tax Board, do you expect your
19 questions for Mr. Taplits to be lengthy or short? What's
20 your expectation?

21 MR. LO GROSSMAN: We expect a short questioning.

22 JUDGE LEUNG: Okay. So let's let Franchise Tax
23 Board question Mr. Taplits first.

24 Go ahead Mr. Lo Grossman.

25 ///

1 CROSS-EXAMINATION

2 BY MR. LO GROSSMAN:

3 Q Okay. I guess as long as we have Exhibits 9, 10,
4 and 11 in front of us, and we're still not putting them on
5 the screen. I have a few questions for you, Mr. Taplits.

6 A Okay.

7 Q Whenever you're ready.

8 A I'm ready.

9 Q All right. You mentioned data analytics in your
10 direct. Where in this contract would data analytics be in
11 Exhibit 9?

12 A Well, I don't know if the term data analytics is
13 specifically written in contract terms. But the vendors
14 and we want to do whatever we can to drive the sales of
15 the product, and we supply data analytics in order to do
16 that. There's a lot of things that we may do but every
17 word -- yeah. I'm not even sure you can quantify it in a
18 contract. Some things you can, and some things you can't.
19 It's just expected that that's one of the things that the
20 company is going to do for you.

21 Q I see. And so are you aware if there was any --
22 I know it sounds repetitive. Sorry. Are you aware if
23 there's a data analytics contract that was provided to
24 your counsel?

25 A I don't believe that a specific data analytics

1 contract was provided.

2 Q All right. With respect to the contracts that
3 are in front of you, is it -- is it correct that these are
4 different items -- that these are different benefits for
5 different items?

6 A I am sorry. What was that? I didn't understand.

7 Q Is it correct that the performance of one item is
8 different from the performance of another item? Are these
9 items given as a group, or are they given one by one when
10 they are --

11 MR. TRESH: If I can, what items? Just to be
12 clear to the witness, what items are we talking about?

13 BY MR. LO GROSSMAN:

14 Q Oh, so -- okay. So we're looking on page 2 of
15 Exhibit 9. The volume allowance, the cooperative
16 advertising allowance, the defective merchandising
17 allowance, are those items, I guess, where you obtained by
18 Appellant on one-by-one basis or are they obtained as a
19 group?

20 A In this contract they're shown separately in the
21 contract.

22 Q Thank you very much. No further questions?

23 JUDGE LEUNG: Thank you, Mr. Grossman.

24 I believe the Judges do have some questions, and
25 I think we're going to take that break right now for

1 15 minutes. So if everyone can mute their microphones and
2 turn off their cameras. Do not disconnect. We'll be back
3 in 15 minutes, and we'll begin with the Judges' questions
4 for Mr. Taplits and any final questions from Mr. Tresh to
5 Mr. Taplits.

6 So I'll see everybody in 15 minutes.

7 (There is a pause in the proceedings.)

8 JUDGE LEUNG: We're back on the record.

9 And we'll start with Judge Akin. Do you have any
10 questions for Mr. Taplits?

11 JUDGE AKIN: Judge Akin speaking here. Yes, I
12 do. Okay. Mr. Taplits, looking at Exhibit 9, and I'm
13 just going to be very careful here so I don't state the
14 vendor's name or the affiliate name or identify, you know,
15 the specific products. But looking at Exhibit 9 --

16 JUDGE LEUNG: Excuse me, Judge Akin. You're sort
17 of breaking up, so if you get closer to the mic it will be
18 better. Thank you.

19 JUDGE AKIN: Thank you. Is this better? Okay so
20 looking at Exhibit 9, and I'm looking specifically at the
21 sections entitled "Promotional Allowance." And then also
22 on page 2 there's a section entitled Co-Op Advertising
23 Allowance. I'm wondering if you can explain what
24 specifically the promotional allowance is being paid for
25 and how it is different from that Co-Op Advertising

1 Allowance.

2 MR. TAPLITS: Let me just read it. From what I'm
3 seeing here, the promotional allowance is that we're
4 promoting a product based on what Liberty Procurement
5 Company set up in the store, whether it's end caps or
6 shelf space or whether they are displays that are in the
7 store. I believe that's what the promotional allowance is
8 for.

9 And it also -- well, it specifies the type of
10 product. But it's promotion other than the co-op
11 advertising. So it's just a different type of promotion.
12 They're both promotional, obviously, but co-op advertising
13 is a different type of promotion. It's, you know, as I
14 said it could be flyers. It could be other types of
15 advertising that we're asking the vendor to share in the
16 cost. Plus, I'm pretty sure we do a markup on it.

17 JUDGE AKIN: Okay. Thank you. And follow-up
18 question on that. So of the five types of vendor
19 allowances you described, those being markdown
20 reimbursements, vendor rebates, supply distribution
21 charge, vendor compliance, and cooperative advertising
22 allowance, I guess I'm asking which one of these, you
23 know, the promotional allowance here would be classified
24 as?

25 MR. TAPLITS: I mean, my --

1 JUDGE AKIN: Or would it be something other than
2 those?

3 MR. TAPLITS: I'd say it's more of a vendor
4 rebate. I would say it's more of a vendor rebate on that
5 because we're doing what we need to do in order to drive
6 the sales of the product, so we're promoting it. So I
7 would call it a vendor rebate.

8 JUDGE AKIN: Okay. Thank you. And then I had
9 just one final question. So you testified that you
10 consider these vendor allowances to be gross receipts. Do
11 you know if they were recorded for financial accounting
12 purposes as revenue?

13 MR. TAPLITS: When you say revenue, they're
14 certainly recorded as income, but they are in cost -- most
15 of them are in cost of goods sold as a reduction in cost
16 of goods sold. The only one that is recorded in, quote,
17 unquote, "revenue," is the co-op advertising, which is
18 recorded under general accepted accounting principles as
19 in -- as a -- what do you call it? -- a contra
20 advertising expense. So the way it's recorded is on the
21 expense line it's contra advertising, you know, but it is
22 still coming in as earned monies.

23 And the same thing whatever goes through the cost
24 of goods sold, it's still coming in as revenue just for
25 gap purposes. It goes through cost of goods sold. The --

1 and -- the -- the issue -- the issue that I had original
2 discussions with when we did the treasury securities and
3 the vendor allowances, you know, California law just does
4 things different from the way gap is. And that's similar
5 to a lot of even federal tax laws in some respects that
6 are different from gap. It just so happens that
7 California is -- has some unique aspects to it.

8 JUDGE AKIN: Thank you. And no further questions
9 from me.

10 MR. TAPLITS: Thank you.

11 JUDGE LEUNG: Thank you, Judge Akin.

12 Judge Le, do you have any questions for the
13 witness?

14 JUDGE LEUNG: This is Judge Le. I have no
15 questions for the witness.

16 MR. TAPLITS: Thank you, Judge.

17 JUDGE LEUNG: Thank you, Judge Le.

18 And I do have some questions for you,
19 Mr. Taplits. Getting back to Judge Akin's last question,
20 you're Exhibit 13 which is the 10-K -- let me know when
21 you get to it.

22 MR. TAPLITS: I don't know where it is in this
23 book that I have. Hold on. Let me see if I can find it.
24 I mean, I have the full 10-K, Exhibit -- Okay. I see it.
25 It's a full 10-K. It's a huge document. Okay.

1 JUDGE LEUNG: All right. I'm looking at Item
2 Number 6. I believe it's on page 14, the "Statement of
3 Earnings."

4 MR. TAPLITS: Hold on. One, two -- oh. Are the
5 pages numbered? Okay. Good. Okay. 14. Hold on.
6 Page -- page 14 of 68 you're talking about?

7 JUDGE LEUNG: I have 14 of 66, but that could be
8 different. Item 6 is after all the high-level executive
9 discussion about the performance of the company? It's the
10 statement of earnings.

11 MR. TAPLITS: Okay. I'm looking at what you
12 have. The problem is I have -- as I mentioned, they
13 didn't open the latest exhibits. I still have --

14 JUDGE LEUNG: Oh.

15 MR. TAPLITS: Is it -- Judge, is it possible to
16 put it -- have it put on the screen or no?

17 JUDGE LEUNG: That will be difficult from our
18 end.

19 MR. TAPLITS: Okay. Select -- I have select
20 financial data.

21 JUDGE LEUNG: The first set of financials. It's
22 like a table with four or five years. It's got your net
23 sales. It's got your gross profit, all that stuff on
24 there.

25 MR. TAPLITS: Okay. I think I have it. What

1 page did you say? I have it on page -- did you say
2 page 16?

3 JUDGE LEUNG: 14.

4 MR. TAPLITS: Oh, mine is -- I think the one I
5 have is on page 16. It says, "Financial Data." That's
6 what you're talking about?

7 JUDGE LEUNG: Yeah. It's got like --

8 MR. TAPLITS: Okay. I got it. I think I have
9 it. Okay.

10 MR. TRESH: It is page 16, Judge, for
11 Mr. Taplits' book.

12 JUDGE LEUNG: Okay. It's got years 2011, 2010,
13 2009, 2008 --

14 MR. TAPLITS: Yes.

15 JUDGE LEUNG: -- personalized net sales. The
16 next line is gross profit.

17 MR. TAPLITS: Yes.

18 JUDGE LEUNG: So my question would be that
19 follow-up on Judge Akin's question. All these vendor
20 allowances would not appear -- it's not in the line that
21 says net sales; correct?

22 MR. TAPLITS: Correct.

23 JUDGE LEUNG: And it's not in gross profit;
24 correct?

25 MR. TAPLITS: No. It is -- it is in gross profit

1 as --

2 JUDGE LEUNG: That's a net.

3 MR. TAPLITS: -- as a reduction of cost of goods
4 sold. So it's in gross profit.

5 JUDGE LEUNG: Okay. So when you file your
6 federal or state return, the numbers you would put down on
7 that return would be -- as for the sales would be that
8 first line, and then gross profit would be from the second
9 line. So that would be -- the vendor allowance amounts
10 would be -- would not be apparent when someone looks at
11 the -- either the federal or state return?

12 MR. TAPLITS: It would not be apparent on the
13 first -- per page 1 of the federal return, it would not be
14 apparent. That is correct.

15 JUDGE LEUNG: Okay. Okay. That's the last one
16 to clarify as follow up on Judge Akin's question. Did Bed
17 Bath & Beyond ever receive forms 1099, either whatever the
18 alphabet soup follows miscellaneous or K from the vendors
19 for these services?

20 MR. TAPLITS: No, they did not.

21 JUDGE LEUNG: Okay. And for purposes of sales
22 tax, when a consumer walks into a Bed Bath & Beyond store
23 and let's say a product is selling for 100 bucks and as a
24 mark down to, say, \$95. Does the consumer pay the sales
25 tax or use tax on the \$100 or \$95?

1 MR. TAPLITS: If there's a cash discount, you're
2 saying, to the consumer?

3 JUDGE LEUNG: Hm-hm. Yes.

4 MR. TAPLITS: If there's a cash discount that is
5 a Bed Bath discount as opposed to a manufacturer's
6 discount, it would be on the \$5.

7 JUDGE LEUNG: Oh, you mean the 100 bucks or the
8 95 bucks?

9 MR. TAPLITS: Oh, I'm sorry. I thought you meant
10 there was a \$95 discount. I'm sorry. It would -- I
11 apologize. It would be on the \$95.

12 JUDGE LEUNG: Okay. And that would be the same
13 for the rebate? So the consumer got a rebate either
14 directly from the manufacturer or as a direct reduction in
15 price at the cash register. How would the sales tax
16 configure on that?

17 MR. TAPLITS: If that was the case, it's from the
18 manufacturer, it would be on the \$100 the sales tax.

19 JUDGE LEUNG: Okay. And I guess it would be
20 another follow-up from Judge Akin's question about the
21 breakdown. Is each category broken down, either in your
22 vendor returns or any other subsequent documentations that
23 you submitted to Franchise Tax Board or the general
24 ledger, between the five different categories that you've
25 laid out for us?

1 MR. TAPLITS: Yes. There are actually more than
2 five categories. We were just concentrating on the top
3 ones, and they were all broken down as information that
4 was provided to the Franchise Tax Board. Yes.

5 JUDGE LEUNG: Okay. That is very good. And I
6 believe those are the questions I have. I'm finished with
7 my questions. And Mr. Tresh, I'll allow you five minutes
8 if you wish to follow up with questions for Mr. Taplits.

9 MR. TAPLITS: Thank you, Judge.

10 JUDGE LEUNG: Thank you.

11 MR. TAPLITS: Did we lose Mr. Tresh?

12 JUDGE AKIN: We can't hear you.

13 MR. TRESH: Sorry. Apologies. Thank you, Judge.
14 Just a couple of quick questions.

15

16 REDIRECT EXAMINATION

17 BY MR. TRESH:

18 Q Mr. Taplits, the contracts that were -- are in
19 Exhibits 9, 10 and 11, are they generally representative
20 of the contracts that Bed Bath & Beyond would have with
21 its vendors?

22 A Yes. They are generally representative.
23 Different contracts and different lanes, but yes.

24 Q And, Mr. Taplits, you mentioned Mr. Dave
25 Denenberg earlier in your testimony. What was

1 Mr. Denenberg's title at the company, if you recall?

2 A I have to look it up.

3 Q That's okay.

4 A I apologize. He was the vice -- his title was
5 Vice President of Merchandise Integration and Strategy.
6 That was his last title.

7 Q And, Mr. Taplits, did Mr. Denenberg oversee the
8 vendor allowance program? Was that one of his job
9 responsibilities?

10 A Yes, he did.

11 Q And Mr. Denenberg submitted an affidavit in this
12 case; is that correct?

13 A Yes, he did.

14 Q And have you read that affidavit?

15 A Yes, I did.

16 Q And do you agree with what's in that affidavit?

17 A Yes, I do.

18 MR. TRESH: Thank you, Mr. Taplits.

19 No further questions, Your Honor.

20 MR. TAPLITS: Thank you.

21 JUDGE LEUNG: Thank you, Mr. Tresh.

22 And, Mr. Taplits, we thank you for testifying
23 today. We hope you stay dry and stay safe and have a
24 great day.

25 MR. TAPLITS: Yeah, the weather happens to be

1 pretty good right now, but thank you, Judge. I appreciate
2 it.

3 JUDGE LEUNG: Well, we had the same thing here
4 over the weekend, so I feel for you. But you're welcome
5 to stay and view the hearings if you desire, if not, you
6 have a great day. Thank you.

7 MR. TAPLITS: Judge, do you mind if I put on --
8 take off the video and the mute -- and I mute it if I stay
9 on?

10 JUDGE LEUNG: Sure. Absolutely.

11 MR. TAPLITS: Thank you, Judge.

12 JUDGE LEUNG: Okay. Mr. Lo Grossman, you have
13 45 minutes for your presentation. You may begin at your
14 pleasure.

15 MR. LO GROSSMAN: Can you hear me?

16 JUDGE LEUNG: I can hear you.

17 MR. LO GROSSMAN: All right. Thank you.

18

19 PRESENTATION

20 MR. LO GROSSMAN: Hello. My name is Thomas
21 Lo Grossman, and I will be representing Franchise Tax
22 Board on appeal today. With me as co-counsel is Craig
23 Swieso who also will be representing Franchise Tax Board.

24 There are three issues on appeal, all of which
25 arise from refund claim denials. The first issue is the

1 treasury activities issue. The second issue is the vendor
2 allowance gross receipts issue, and the third issue is the
3 vendor allowance assignment issue.

4 The first issue is the treasury activities issue
5 and asks whether or not treasury activities are properly
6 reportable in the sales factor denominator. And this
7 issue turns on the continuing validity of Appeal of Fluor.
8 The second is the vendor allowance issue and asks whether
9 or not each of the various kinds of vendor allowances on
10 appeal are reportable as gross receipts in the sales
11 factor denominator. There are many different kinds of
12 vendor allowances which will be gone into greater detail
13 later.

14 Finally, the third issue is the vendor assignment
15 issue, and it arises as a corollary to the vendor
16 allowance gross receipts issue. And it asks whether any
17 of the classes of transactions that your tribunal deems to
18 be reportable in the gross receipts' sales factor
19 denominator as report -- should also be reported in the
20 sales factor numerator as assignable to California under
21 the cost of performance rules.

22 So with respect to the treasury activities issue,
23 the facts are stipulated. There's -- it's not in question
24 that there's a regulation that's directly on point. It's
25 25137(c) (1) (d). The Appeal of Fluor provides that where

1 the facts that are specific to a regulation are on point,
2 that that regulation will control irrespective of the
3 standard apportionment formula in UDITPA, which would
4 include 25120 to 25136.

5 We do not dispute that Microsoft holds that under
6 the standard apportionment formula treasury
7 receipts are -- treasury activities do constitute gross
8 receipts. That's -- it's -- that's clearly the case that
9 under 25120 that is true. We don't dispute that the
10 legislature changed 25120 by amendment of -- on a
11 prospective basis. The authority for the regulation,
12 however, comes from Section 25137, and there is binding
13 precedent that says that where the regulation -- where
14 there is a 25137 regulation and the facts are on point,
15 that treasury -- that the regulation will control, and we
16 have that here.

17 There are treasury activities. The regulation
18 provides that they are not reportable in the sales factor
19 denominator. I would point out that Appellant mentioned a
20 little bit about distortion towards the end of their
21 argument. And it is true that Appeal of Fluor provides
22 that you can still use distortion where a 25137 regulation
23 is on point. What Appellant left out, however, is that
24 when you attempt to use the -- make a distortion argument
25 in the presence of a 25137 regulation that is directly on

1 point, it's the 25137 regulation that becomes standard for
2 purposes of determining distortion.

3 It's whether or not the 25137 regulation that is
4 distortive becomes the issue. And so Appellant's
5 contentions that there aren't actually that many treasury
6 receipts that would be found distortive militates against
7 their position because under Appeal of Fluor the 25137
8 regulation is controlling. And since there aren't many
9 receipts, Appellant is arguing that there isn't
10 distortion.

11 Since it would be Appellant's burden to show
12 distortion, it's -- it's very hard for Appellant to make a
13 showing of distortion when the -- when they are saying
14 that there aren't a lot of gross receipts, and the
15 standard formula is the one under 25137 under Appeal of
16 Fluor. So to summarize Issue One, there's a regulation
17 that is directly on point, and there's a case that says
18 that regulation is controlling and those treasury
19 receipts -- treasury activities are not reportable in the
20 sales factor denominator.

21 With respect to the vendor allowance issue, a
22 little bit of detail needs to be gone into, a little bit
23 of background. Appellant's claim arises from an amended
24 return. And so on claim review it was determined that
25 that amended return, the figures that Appellant used to

1 make its claim were derived from many, many different
2 general ledger accounts that had -- had a -- what -- what
3 joined these general ledger accounts was their accounting
4 treatment, not necessarily the underlying activities for
5 the general ledger accounts.

6 So Appellant booked in its general ledger many
7 contra cost of goods sold items, and these included the
8 vendor rebates, the markdown reimbursements, the supply
9 distribution charges, the vendor compliance fees, some of
10 the cooperative advertising, and many, many other general
11 ledger accounts, many of which seem to have the word
12 promotional as a prefix. And what happened is all of
13 those general ledger items were turned into a claim for
14 California apportionment purposes. So, although, these
15 items were reported as contra cost of goods sold for
16 financial accounting purposes, not as income for income
17 tax purposes, but they were reported as gross receipts for
18 California apportionment purposes on the claim.

19 And a couple of things to point out. 87 percent
20 of the general -- of the purported gross receipts come
21 from the four main vendor allowances, vendor rebates,
22 markdown reimbursement, supply distribution charges, and
23 vendor compliance fees. As far as we can tell, about 1
24 percent comes from cooperative advertising because we
25 think it relates back to the advertising charge-back

1 general ledger account. And the balance relates to other
2 items, other things. We don't know.

3 And this creates some issues because of the
4 myriad vendor allowances that are being discussed, we --
5 the four main ones we have quite a bit of documentation on
6 it at this point. And so we can relate whatever
7 discussion is going on about the four main vendor
8 allowances back to the documents and then back to the
9 general ledger. There's been a bunch of discussion of
10 cooperative advertising too, so we can relate the
11 discussion of the cooperative advertising vendor allowance
12 back to the general ledger and back to the claim.

13 All these other vendor allowance discussions,
14 like the SodaStream and the Keurig that were mentioned
15 earlier by the witness, promotional advertising, data
16 analytics, it's not clear, necessarily, whether those
17 vendor allowances, which are separate, are necessarily
18 even related back to the general ledger accounts, which
19 are the basis for the claim. There isn't that kind of
20 documentary trail relating back. Discussion of various
21 other vendor allowances, besides the main ones, back to
22 the general ledger, which constituted the base of
23 Appellant's claim.

24 So that creates a real substantiation issue. We
25 don't necessarily know what Appellant's original return

1 position is for some of the items they discussed, and
2 Appellant has not cleared that up. So that creates a
3 serious, you know, factual question as to whether or not
4 some of these additional allowances are even part of the
5 claim on appeal.

6 With respect to the four main vendor allowances,
7 those are definitely on appeal. Appellant has provided
8 documentation about what goes into the vendor rebate
9 allowance, the markdown reimbursement allowance, the
10 supply distribution charge, and the vendor compliance
11 fees, as well as the cooperative advertising. So based on
12 those documents, it's clear that none of them constitute
13 gross receipts for the simple reasons that the vendor
14 rebates are volume purchase discounts. And a volume
15 purchase discount by its nature cannot be separated from
16 the underlying purchase of goods.

17 The way to earn more volume purchase discounts is
18 to purchase more volume, and the markdown -- and the
19 reimbursement is against the purchase price. It's hard to
20 see a separable service there. With respect to the
21 markdown reimbursements, it's a price adjustment on goods
22 that aren't selling for sufficient -- or sufficient as far
23 as the contract is concerned, price. And that is also
24 intimately linked to the underlying purchase of goods. A
25 markdown reimbursement can't be separated from the

1 underlying purchase of goods.

2 The supply distribution charge is a protection
3 against cost overruns on shipping and handling that
4 Appellant is charged by its vendors. A vendor in the
5 course of its business buys goods, and sometimes it agrees
6 to pay shipping and handling charges. What the supply
7 distribution charges constitute is protection against
8 being overcharged by the vendors. But, of course, that's
9 inseparable from the underlying purchase of goods.

10 The vendor compliance charges are charge backs
11 for where there are qualitative failures in vendors'
12 supplying of goods. I think the example was lateness or
13 other failures in shipping and handling. That's
14 inseparable from the underlying purchase of goods. So
15 those 87 percent, which is what was discussed broadly in
16 the documentation, are not gross receipts because they
17 cannot be separated from the goods purchases.

18 With respect to cooperative advertising, the
19 issue isn't so much whether or not cooperative advertising
20 is income. The issue is that the items are a
21 dollar-for-dollar reimbursement. So -- and there's some
22 support for that in the text box at Exhibit 11. But
23 Appellant, under the cooperative advertising documentation
24 based on what we see on Exhibit 9 and 11 and I believe at
25 10, there is -- just 9 and 11 -- there is a reimbursement

1 of charges where Appellant advances expenditures to buy
2 advertising on behalf of its vendors. It is reimbursed
3 dollar-for-dollar.

4 We know this because the mechanics of the
5 contracts say so by its vendors. And for that reason,
6 Appellant is acting as a conduit, and it does not
7 constitute gross receipts. The reason a dollar-for-dollar
8 reimbursement does not constitute a gross receipt is
9 because Lincoln Merchandising, which is a Supreme Court
10 case, says that reimbursements do not constitute gross
11 receipts.

12 The -- if cooperative advertising was not being
13 reimbursed on a dollar-for-dollar basis, it very well
14 could be a gross receipt. But based on all of the
15 documentation provided by Appellant, they do appear to be
16 reimbursed on a dollar-for-dollar basis. And it is for
17 that reason the cooperative advertising does not
18 constitute a gross receipt.

19 With respect to the myriad of other allowances,
20 we just don't have the documentation. Appellant was asked
21 repeatedly. We never did obtain contracts until the third
22 Respondent's -- brief by Appellant. And based on the
23 contracts we have, we're -- there's no evidence that any
24 of it would constitute a gross receipt. Appellant has
25 been very consistent with its narrative explanation of the

1 main vendor allowances.

2 They were asked to explain the vendor allowances
3 in 2015 -- well, it looks like it was 2014, but their
4 answer came January 26th, 2015. And there was no mention
5 of anything like analytics or anything other than the
6 narrative explanation that's in the briefing. They were
7 asked again on March 16th, 2016. They did not mention
8 anything about analytics or anything other than what was
9 in the briefing or in the affidavit.

10 On 2019 in their briefing, they explained what
11 the four main vendor allowances were. They were
12 consistent with what was said in prior years and was very
13 consistent with what is in the affidavit of Mr. Denenberg.
14 Mr. Denenberg explained in Item 7 of his affidavit what
15 those allowances were. He described, again, the vendor
16 rebate as a volume discount; the markdown reimbursement as
17 a price adjustment; the supply distribution charge as a
18 protection against cost overruns on shipping and handling;
19 and vendor compliance fees as a charge back for
20 qualitative failures.

21 This was in an affidavit that was sworn by one of
22 Appellant's employees. Appellant -- that witness is
23 not -- was not here to comment on the affidavit.
24 Although, the witness we just heard confirmed that he
25 agrees with what the affidavit of Mr. Denenberg says. The

1 gross allowance, there's some discussion of the gross
2 allowance in Exhibit 10 that we got on February 19th of
3 2020, which the witness described it as a separate item as
4 all the vendor allowances are separate items. And, again,
5 what you're seeing there is a volume-based allowance.

6 So there's a remarkable consistent narrative as
7 to what these allowances are for, and they do not -- and
8 what they are for does not constitute gross receipts.
9 With respect to the assignment issue, which is Issue
10 Three, the Appellant has argued that all of the cost of
11 performance would be born in the headquarters area at the,
12 you know, Liberty Procurement center. Which creates an
13 issue because to the extent Appellant is arguing that the
14 cost of performance for obtaining these vendor allowances
15 is merely administering the obtaining of -- the
16 negotiating the obtaining of these vendor allowances.

17 That argues against the fact -- the argument that
18 there's actually a broad service being performed. To the
19 extent that there is a service being performed in the
20 field, which you would expect if these were broad services
21 that were being provided, that would tend to push the cost
22 performance out towards stores such as -- and where the
23 most stores are in California, based on Appellant's
24 financial statements.

25 The cases that Appellant has cited to are

1 software royalty cases. The analogy to the present facts
2 is not clear. The purported services being provided are
3 volume discounts, markdown reimbursements. Presumably the
4 purchase orders are being handled through the stores. We
5 haven't received any testimony on that.

6 The supply distribution charge, well, since it's
7 a -- since it's a -- it's inseparable for the underlying
8 goods, and the purchase orders are being handled through
9 the stores, which are moving the product. Presumably that
10 would also be handled through the California stores, and
11 the same would be true of vendor compliance fees. There's
12 discussion with respect to cooperative advertising, we
13 know from Exhibit 9 that to the extent that it's a gross
14 receipt, it's a reimbursement of money spent on local
15 media.

16 Local media -- the direct cost of buying local
17 media are born locally, and the way more reimbursements
18 are earned is by spending more locally. So the cost of
19 performance of earning that item would also be born
20 outside of the headquarters in the Greater New York area.
21 It would be earned in the field. California is the
22 biggest market. California has the most throughput of
23 goods. So to the extent your tribunal deems that there is
24 indeed a gross receipt generated from these items, the
25 best guess we have would be that the cost of performance

1 would be in California.

2 The reason we are making these sorts of broad
3 suppositions is we have not received any documentation
4 from Appellant. Again, we've been asking since at least
5 2015 for some explanation as to the cost of performance.
6 Appellant has provided testimony to the effect that some
7 of the -- that the cost in the field would be wrote. That
8 doesn't make them any less -- any less expensive. That
9 just means that there's not a lot of headquarter inputs
10 into it. I mean, there just isn't a lot of flexibility,
11 and we don't have a breakdown of the cost of performing
12 the various vendor allowances that were obtained by
13 Appellant.

14 So that concludes my direct presentation. I'd be
15 happy to answer any of your questions.

16 JUDGE LEUNG: Thank you, Mr. Lo Grossman.

17 Judge Akin, do you have any questions for the
18 Franchise Tax Board?

19 JUDGE AKIN: Judge Akin speaking. I do not have
20 any questions. Thank you.

21 JUDGE LEUNG: Thank you, Judge Akin.

22 Judge Le, any questions for the Franchise Tax
23 Board?

24 JUDGE LE: This is Judge Le. I have one
25 question. Appellant discussed the -- sort of the

1 discrepancy between the statute under 25120 and Regulation
2 25137. The statute that says that treasury receipts are
3 excluded on/or after 2011, and the reg says treasury
4 receipts are excluded on/or after 2007. How should the
5 OTA resolve that discrepancy?

6 MR. LO GROSSMAN: Well, the legislation that
7 enacted the changes to 25120, what it did is it
8 prevented -- it allows gross receipts to -- as a matter
9 of -- under the standard formula, not be reported in the
10 sales factor denominator. That's -- and that's under the
11 authority of Section 25120. The regulation is under the
12 authority of Section 25137, which by -- and the regulation
13 in that statute is an express override in UDITPA of the
14 standard apportionment formula.

15 So to the extent a determination under 25137 is
16 in conflict with the standard formula, the 25137
17 determination would override. That's actually what
18 happened with the treasury receipt in Microsoft. The
19 court in that case determined that, yes, treasury receipts
20 under the standard formula are indeed gross receipts under
21 Section 20120. But under the facts and circumstances
22 present under Section -- in the Microsoft case before the
23 court, that Section 25137 would override.

24 What Appeal of Fluor did was it provided that
25 regulations that are promulgated under Section 25137, such

1 as the 25137(c) (1) (d), are valid without a requirement for
2 a showing of distortion on either part. They're binding
3 without a requirement of a distortion finding on either
4 party and, therefore, that the 25137 regulation would
5 override the standard formula. So because 25137 provides
6 a statutory override under 25120, under Appeal of Fluor,
7 25137 regs are allowed to under -- override the standard
8 apportionment formula under 25120.

9 JUDGE LE: Thank you. No further questions.

10 JUDGE LEUNG: Thank you, Judge Le.

11 I'm going to follow up with Judge Le's questions
12 about the amendments to 25120(e) creating the new
13 25120(f). When the law was changed in 2009, effective
14 2011, was that law changed as a result of a nudge proposal
15 made by the Franchise Tax Board, Mr. Lo Grossman?

16 MR. LO GROSSMAN: I do not have that information.

17 JUDGE LEUNG: Okay. And do you know why the
18 legislature delayed the operative date of that statute to
19 2011?

20 MR. LO GROSSMAN: No. I do not know that, Judge.

21 JUDGE LEUNG: In your mind, would that delay mean
22 that the legislature wanted the treasury function to be a
23 gross receipt until 2011?

24 MR. LO GROSSMAN: Well, it's -- I mean, it's hard
25 to say what the motivations of a collective body are. So

1 to the extent that there was, you know, an expressly
2 prospective application of a new 25120 rule, they would --
3 I mean, they clearly wanted that to be prospective only
4 for purposes of 25120. But 25137 was not overrode. I
5 mean, 25137 was left very much intact, and I think the
6 regulation went out in 2008. Yeah. I mean, it was
7 promulgated from 2008 forward. So there was no
8 communication on the legislature one way or another how
9 they wanted 25137 to apply with respect to treasury
10 receipts under the state.

11 JUDGE LEUNG: Okay. Going to your Regulation
12 25137(c) (1) (d), as in David, during the admin process to
13 adopt that regulation, did Franchise Tax Board hold an
14 interest of parties meetings.

15 MR. LO GROSSMAN: It did. It did. It held an
16 interest of parties meeting. It specifically invoked
17 Microsoft. It specifically -- and the rule-making file is
18 immense, but from the rule-making fire -- flop -- file,
19 the express goal of the 25137(c) (1) (d) was to make it
20 administrable. The treasury activities cases which were a
21 serious administrable -- had become a serious
22 administration concern, and Microsoft and General Mills
23 were specifically incorporated into why the 25137(c) (1) (d)
24 reg was taking place.

25 JUDGE LEUNG: And how many of those meetings did

1 you have before it went into formal hearing process?

2 MR. LO GROSSMAN: Formal hearing. I would have
3 to look that up. I don't have that information on me.

4 JUDGE LEUNG: More than one?

5 MR. LO GROSSMAN: I don't -- the regulation went
6 through pretty quickly. It's not clear that there was
7 more than one.

8 JUDGE LEUNG: And was it well attended by the
9 public?

10 MR. LO GROSSMAN: Yes. Yes, it was. There
11 were --

12 JUDGE LEUNG: And -- go ahead.

13 MR. LO GROSSMAN: There were many signatures.

14 JUDGE LEUNG: And a lot of input from the public?

15 MR. LO GROSSMAN: There was. There was. The
16 regulatory process went through the Office of
17 Administrative Law and Department of Finance. It went
18 through the entire regulatory process. There was public
19 comment. If I recall, the in-state interests were very
20 supportive of the regulation. The out-of-state interests
21 were not supportive of the regulation. General motors
22 wrote a -- General Motors was displeased. There's a
23 comment in the regulation for -- about that.

24 JUDGE LEUNG: Okay. Now, Mr. Tresh or
25 Mr. Gustafson spoke about some sort of -- or even the

1 witness, Mr. Taplits, talked about -- talked about some
2 sort of hearing even the witness Mr. Taplits talked about
3 some sort of settlement --

4 MR. LO GROSSMAN: Yes.

5 JUDGE LEUNG: -- regarding the treasury function.
6 When did that settlement program end, if there was one?

7 MR. LO GROSSMAN: There -- well, it was a
8 settlement program. So strictly speaking, the settlement
9 program covered years prior to those under the years at
10 issue. With respect to the administrative practice of the
11 administration of that settlement program, I am not aware
12 of whether or not it formally ended.

13 JUDGE LEUNG: Well, as far as you're concerned
14 that only taxpayers' return as of a particular date
15 qualify for that settlement program?

16 MR. LO GROSSMAN: That is correct. Yes, Judge.
17 That is correct. The settlement agreement by its own
18 terms covers years prior to those under -- those on
19 appeal. The cutoff date was the year the regulation went
20 into effect.

21 JUDGE LEUNG: Okay.

22 MR. SWIESO: May I make a comment, Judge Leung?

23 JUDGE LEUNG: Yes, sir.

24 MR. SWIESO: Terminology, technically speaking,
25 it wasn't a settlement program through the Franchise Tax

1 Board's Settlement Bureau. It was classified as a
2 resolution so that there wouldn't be ongoing litigation
3 with respect to the matter. It technically wasn't a
4 settlement through the Franchise Tax Board's Settlement
5 Bureau. I just want to make that clear.

6 JUDGE LEUNG: So, basically, these are all
7 closing agreements?

8 MR. SWIESO: Correct.

9 JUDGE LEUNG: Thank you.

10 MR. SWIESO: They weren't settlement agreements.

11 JUDGE LEUNG: Thank you for that the
12 clarification.

13 I don't have any questions at this time for
14 Franchise Tax Board.

15 And, Mr. Tresh or Mr. Gustafson, I'll give you
16 guys the option. You have 20 minutes to close. You can
17 go about that right now, or we can take a break and come
18 back afterwards.

19 MR. TRESH: If could we take a -- could we take
20 five-minute break, Your Honor, and then come back in 5 or
21 10 minutes and do a close?

22 JUDGE LEUNG: Okay. I'll give you 10. When you
23 come back, you'll do your close and for the Judges' final
24 questions. Okay. But we'll break for 10 minutes now.

25 MR. TRESH: Thank you, Your Honor.

1 JUDGE LEUNG: Mute your mics and shut your
2 videos.

3 (There is a pause in the proceedings.)

4 JUDGE LEUNG: This is Judge Leung. We're back on
5 the record, and we're ready for a closing from either
6 Mr. Gustafson or Mr. Tresh.

7 Gentleman, which one?

8 MR. TRESH: Your Honor, I'm going to take a shot
9 at this, if it pleases the Court.

10 MR. TAPLITS: Absolutely.

11

12 CLOSING STATEMENT

13 MR. TRESH: Okay. So Your Honors, as we've
14 talked about today, there are essentially three issues
15 that we have before us. We have the treasury receipts
16 issue. We have the vendor allowance issue, and then we
17 have what I'll call are the sourcing issue. Okay.

18 I'll begin with the treasury receipts issue. We
19 heard a lot about that from Mr. Gustafson in the beginning
20 of our opening presentation. I guess maybe what I would
21 like to add to that, without belaboring the point, is a
22 chronology. And that chronology is that the way treasury
23 receipts has been an issue. Whether to include them in
24 the denominator of the apportionment formula has been an
25 issue in California for -- oh, god, an excess of 20 years

1 now. And here's kind of how it went down.

2 Microsoft being the lead case litigated the issue
3 of whether treasury receipts should be included in the
4 denominator of the sales factor, and in 2006 the
5 California Supreme Court decided that case. California
6 Supreme Court said, yes, treasury receipts are included in
7 the denominator absent to showing of distortion. Black
8 letter law.

9 So then what happens? FTB is aggrieved by that
10 holding, and FTB says we're going to promulgate a
11 regulation, and we're going to do it under a different
12 statute. We're going to say it's presumptively
13 distortive. And so they promulgate this 2008 regulation.
14 And as Your Honor pointed out, they did do it through the
15 Administrative Rules Process, and they received some input
16 from a lot of people. It's a voluminous record saying
17 that we don't think that FTB has the authority to
18 essentially reverse the California Supreme Court. A.

19 And so despite receiving all that feedback, FTB
20 goes ahead and very quickly promulgates the regulation
21 anyway. So then what happens? So the legislature sees
22 what the FTB has done, and not less than a year later in
23 2009, the legislature comes in and says we're going to
24 change the law, and we're going to change the law
25 effective 2011. That is a very purposeful decision on

1 behalf of -- on the part of the legislature to go ahead
2 and say, we're going to begin including treasury receipts
3 in the sales factor denominator beginning in 2011.

4 Now, Mr. Lo Grossman makes the argument and says,
5 well, how I'm going to reconcile that is our regulation is
6 promulgated under a different statute. But here's the
7 problem with that argument. That argument essentially
8 nullifies. It makes moot and meaningless what the
9 legislative did during the years 2009 through 2011.
10 Because if Mr. Lo Grossman were right, the treasury
11 receipts are just distortive no matter what for 2009 and
12 2011, and no taxpayer could ever include them.

13 And what the legislature did by not making the
14 law effective until 2011 is absolutely meaningless. Just
15 enact a law. All the legislature would be due at that
16 point. Why go ahead and put in an effective date on that
17 statute two years later? Well, the why is simple. The
18 why is that because FTB disregards all the commentary they
19 got on their regulation and because for whatever reason,
20 the legislature made a choice to go ahead and change the
21 law. They did so, but they gave taxpayers a bit of
22 forewarning and went ahead and changed it as of 2011.

23 What the FTB is trying to do in this case is make
24 a run around that California Supreme Court's decision in
25 Microsoft and then the legislature's actions, which

1 happened after their regulation, and went ahead and told
2 us how treasury receipts should be treated. Now, there
3 may be ways to reconcile the Appeal of Fluor, which is a
4 Board of Equalization decision. But to the extent that
5 what FTB is saying is that we can enact a regulation that
6 overturns an action of the California Supreme Court and
7 overturns an action of the state legislative. That cannot
8 be permitted.

9 FTB does not have that authority. They cannot
10 enact regulations that are at direct odds with the law,
11 and it cannot enact regulations that render the law
12 meaningless. And so for that reason we would argue that
13 for these time periods at issue, Bed Bath & Beyond's
14 receipts should be included in the sales factor
15 denominator. This is not an issue that goes forward. The
16 law has been changed, and it is what the legislature says
17 it is. So we respectfully ask that those receipts be
18 included in the sales factor denominator.

19 Now, I'm going to turn next to the vendor
20 allowance issue. In the vendor allowance issue, I don't
21 think we have much of a debate about what the law says.
22 The law speaks to all gross receipts. I think our primary
23 issue is are these vendor allowances, these various
24 categories of vendor allowances, receipts? And I think
25 for that you have to go with the record that's in front of

1 you.

2 Mr. Lo Grossman, I think, attempted to provide
3 some factual testimony as to what his view of the
4 transactions were, but here's what we know. Here are the
5 facts and evidence before this body. We know that there's
6 an affidavit from Mr. David Denenberg, and there's
7 testimony from Mr. Steve Taplits, and that uncontroverted
8 testimony all says that these vendor allowances were
9 receipts. Now, you may ask why? Why? Does that make
10 sense?

11 Well, again, the uncontroverted testimony shows
12 that Bed Bath & Beyond performs a variety of services to
13 go ahead and earn those receipts. You have in front of
14 three representative contracts, all of which talk about
15 Bed Bath & Beyond earnings. That's what the contract
16 says, earn. Use those word. It's not a discount in
17 purchase price. It's not a rebate. It's money they earn.
18 That word is purposeful, and they earn that money from
19 doing certain things.

20 Now what do they do? They have a group of 3 to
21 400 people, again, uncontroverted testimony, that goes
22 ahead and operates out of New York and New Jersey out of a
23 company called Liberty Procurement. And that company
24 centralizes all of the operations associated with the
25 vendor allowances, among other things. And what that

1 company does, for example, is they centralize purchasing.
2 I think Mr. Lo Grossman attempted to say or did say, which
3 was incorrect, that the buying occurs at the store level.
4 That's not true.

5 Stores don't buy anything. All the purchasing
6 decisions are made in New York and New Jersey. What's
7 also true is as part of each of these vendor allowances,
8 uncontroverted testimony in this case shows that data
9 analytics are supplied as part of each of the vendor
10 allowances. Now, I take Mr. Lo Grossman's point that
11 perhaps that information around exactly what were the data
12 analytics and what have you wasn't supplied in a myriad of
13 documents. I don't know all the discussions that Best Buy
14 [sic] people had with FTB's audit staff.

15 I mean, there were numerous, numerous phone
16 calls. The audit staff was not brought here to testify as
17 to what did or what was or what was not conveyed in those
18 discussions and perhaps that's unfortunate. But we do
19 know that we have uncontroverted testimony that things
20 like data analytics, advertising services, purchasing,
21 decisions, all of these activities that Bed Bath & Beyond
22 was compensated for, we have uncontroverted testimony that
23 those decisions and that service was provided using
24 technology that was maintained in New York and New Jersey
25 using a group of hundreds of employees that resided in

1 New York and New Jersey.

2 And to the extent that a store personnel set up
3 the end cap display, that personnel didn't have any sort
4 of independent authority as Mr. Taplits testified. Those
5 decisions who got the end cap and where the product was
6 placed and whether or not the luggage was placed next to
7 the alarm clocks, all of those decisions were made by a
8 highly sophisticated group resident in New York and New
9 Jersey.

10 That's where the services were performed. That's
11 what Mr. Taplits testified those vender allowances were
12 made for, and all of that occurred in either New York or
13 New Jersey, not in California. So with respect to the
14 inclusion of these receipts in the denominator, the
15 contracts that are at issue in this case and the
16 testimony, they all show that these was money that Best
17 Buy earned.

18 The fact that the way the money was paid was that
19 Best Buy went ahead and deducted it from accounts
20 payable -- Best Buy -- Bed Bath & Beyond deducted it from
21 accounts payable. The fact that they did that doesn't
22 change the categorization of how those receipts or the
23 fact that they are receipts in the first place. Simply
24 because I take payment by reducing a payable doesn't mean
25 that the receipts are anything other than receipts.

1 Lastly, Your Honor brought up the sales tax
2 treatment and how these receipts are treated for other
3 means. And I thought that was -- it's obviously a very
4 good question and an instructive one because if what a
5 vendor did was they went ahead and made a conscious
6 decision to charge Bed Bath & Beyond \$90 instead of \$10,
7 period at full stop, and Bed Bath & Beyond didn't have to
8 do anything more, we wouldn't have a case before us today.
9 We wouldn't have an issue.

10 But that's not what happened, and that's not what
11 the evidence shows. The evidence shows that what happened
12 is Bed Bath & Beyond entered into contracts with its
13 vendors. Those contracts gave Bed Bath & Beyond the
14 ability to earn money if it did certain things; data
15 analytics, mark downs, product placement, advertising.
16 And it's only if they did those things that they got that
17 money. That's what happened in this case. Bed Bath &
18 Beyond fulfilled its obligation. It paid for it, and the
19 fact that it was paid by reducing an accounts payable
20 doesn't change any of those underlying facts.

21 For those reasons, we respectfully submit, Your
22 Honors, that Bed Bath & Beyond should include the vendor
23 allowances in its sales factor denominator. And we'd ask
24 that the Court rule in our favor.

25 We thank you very much.

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JUDGE LEUNG: Thank you, Mr. Tresh.

Judge Akin, questions for the parties?

JUDGE AKIN: Judge Akin speaking. I don't have any questions for either party at this time.

JUDGE LEUNG: Okay. Judge Le?

JUDGE LE: This is Judge Le. I do not have any questions for either party.

JUDGE LEUNG: Okay. I do have a follow-up question for you, Mr. Tresh. Perhaps the Franchise Tax Board in a machine, but I'm curious about the -- when you mentioned just now and earlier, about the placement of the product, shelf space, and the fact that a Liberty entity back East negotiated all those terms with the vendors. And my curiosity is, are the vendors paying for the Liberty staff, or are they paying for the space at the store where the product should be arranged to make it more sellable?

MR. TRESH: I don't think it's either, Your Honor. I think what they're being compensated for is these Federal allowances is we've talked about how Bed Bath & Beyond has a lot of data. And if that data would show that Bed Bath & Beyond could earn more money by setting up an end cap in a certain way, then presumably Bed Bath & Beyond would do that. And -- but those decisions as to how those displays were set up or how the

1 store has set up in general, whether or not I position on
2 a shelf the alarm clocks next to the luggage, as you heard
3 Mr. Taplits describe, those decisions are made by the
4 people in New York and New Jersey.

5 So I'm not really paying for the space, and I'm
6 not paying for the people. What I'm paying for is the
7 service of making sure that those products move, if you
8 will, and go off the shelves as quickly and as seamlessly
9 as possible. And, again, this is money Bed Bath & Beyond
10 has an opportunity to earn. If those people don't do
11 their jobs well, Bed Bath & Beyond will not earn that
12 money.

13 JUDGE LEUNG: Thank you. My final question is
14 concerning the audit itself. And, Mr. Tresh, you
15 mentioned that, you know, there are many conversations
16 between the client and Franchise Tax Board regarding the
17 audit. Was this the audit that was conducted at Bed
18 Bath & Beyond or was it a desk audit?

19 MR. TRESH: Your Honor, I'm not sure. I know
20 that there were -- the audit went on for some time, and
21 there was information that was exchanged remotely and
22 electronically in part because during some of the time
23 frame that we were working with FTB, there was -- it was
24 probably during the pandemic at least for some of it. But
25 I can't answer your question as to whether or not there

1 was a part of the audit that was performed on-sight.

2 JUDGE LEUNG: Mr. Lo Grossman, can you shed some
3 light on that? Was this a desk audit or an on-sight
4 audit?

5 MR. LO GROSSMAN: It's not -- the only records we
6 have are the correspondence, and that would not tell us
7 whether or not there was an on-site visit. I apologize.

8 JUDGE LEUNG: Okay. That concludes the oral
9 portion of our hearing. We do have a question that we
10 pose to both parties for additional briefing. The
11 briefing will be due 30 days from today. And the question
12 is this; whether there's a sale and use tax regulation in
13 the State of California Section 1671.118CCR1671.1. And
14 the question we have for the parties is whether that
15 regulation applies to this case? And if not, why not. If
16 so, why so, and how we should apply it. So simultaneous
17 briefing 30 days from today.

18 MR. SWIESO: This is Craig Swieso from the
19 Franchise Tax Board, may I make a comment, Judge Leung?

20 JUDGE LEUNG: Yes, Mr. Swieso.

21 MR. SWIESO: Judge Leung, 30 days from today
22 would be the Friday after Thanksgiving. Is it possible to
23 allow the briefing to be submitted the Monday after the
24 Thanksgiving holiday?

25 JUDGE LEUNG: Well, since it's a State holiday,

1 yes, we will allow the briefing to be due -- it would be
2 November 29th, and make it close of business
3 November 29th --

4 MR. SWIESO: Thank you.

5 JUDGE LEUNG: -- 2021.

6 MR. TRESH: Thank you, Your Honor.

7 JUDGE LEUNG: And we will issue an order
8 confirming that. Any further questions?

9 MR. TRESH: No further questions from Bed Bath &
10 Beyond, Your Honor.

11 JUDGE LEUNG: Thank you, Mr. Tresh.

12 Mr. Lo Grossman, any further questions?

13 MR. LO GROSSMAN: No further questions from
14 Franchise Tax Board.

15 JUDGE LEUNG: Okay. We will leave the record
16 open until we receive those briefs. We wish you all --
17 the next hearing will start at 1:00 o'clock. I wish
18 everybody a good day and a wonderful holiday and stay
19 safe. You have a great day now. Bye-bye.

20 (Proceedings adjourned at 12:26 p.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 22nd day of November, 2021.

ERNALYN M. ALONZO
HEARING REPORTER