STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

DISNEY ENTERPRISES, INC. & :
COMBINED SUBSIDIARIES

DETERMINATION
: DTA NO. 818378

for Redetermination of a Deficiency or for Refund of
Corporation Franchise Tax under Article 9-A of the :
Tax Law for the Fiscal Years Ended September 30, 1990
through September 30, 1995. :

Petitioner, Disney Enterprises, Inc.[1] & Combined Subsidiaries, 500 South Buena Vista Street, Burbank, California 91521, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended September 30, 1990 through September 30, 1995.[2]

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 11, 2003 through February 14, 2003, with all briefs to be submitted by September 4, 2003, which date began the six-month period for the issuance of this determination. Petitioner appeared by McDermott, Will & Emery

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[1] Disney Enterprises, Inc. was formerly known as The Walt Disney Company, its name during the years at issue. The predecessor to The Walt Disney Company was the Disney Brothers Studio, established on October 16, 1923, which created Mickey Mouse five years later on November 18, 1928. Walt Disney was fond of telling people to "remember, this all started with a mouse."

[2] Petitioner's fiscal year runs October 1st through September 30th. Consequently, the six-year period at issue runs from October 1, 1989 through September 30, 1995.

(Arthur R. Rosen, Esq. and Alysse Grossman, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Clifford M. Peterson, Esq., and Robert J. Tompkins, Esq., of counsel).

ISSUES

I. Whether the income of certain subsidiaries of Disney Enterprises, Inc., which allegedly have no nexus with New York individually, may nonetheless be included in income allocable to New York since they are part of petitioner's unitary group, and therefore, their New York destination sales may be included in the numerator of the receipts factor of the business allocation percentage of the combined group and the New York property as well as the salary of New York salespeople employed by one of them may be included in the numerator of the property and payroll factors of the business allocation percentage of the combined group despite the constraints of Federal Public Law No. 86-272 and protections afforded to nontaxpayer corporations by the Commerce Clause of the United States Constitution.

II. Whether New York's application of its business allocation percentage to petitioner's unitary business income, which included royalty income, without including a specific property value for petitioner's intangible property in the property factor of the apportionment formula, violates the Commerce and Due Process Clauses of the U.S. Constitution or alternatively whether the Commissioner's refusal to make an adjustment under Tax Law § 210(8) to the apportionment formula to include petitioner's intangible property in the property factor was an abuse of his discretion to do so.

III. Whether, with respect to petitioner's royalty income from its licensing activities, it should be permitted to reduce the numerator of its receipts factor based upon an error allegedly made in its original computation by now sourcing such income based upon the geographic location where the

licensee's products were manufactured rather than merely the business location of the licensee noted in the licensing agreement or contract.

IV. Whether film masters owned by the Disney corporate group should be included in the property factor at their fair market value instead of at a value equal to their original cost, and if they are included at the lesser value equal to their original cost, whether net income arising from the ownership of the film masters should be excluded from the entire net income subject to tax.

FINDINGS OF FACT

1. Petitioner, which maintains its executive offices in Burbank, California, is a diversified international company engaged in family entertainment with operations in three business segments: (i) theme parks and resorts, (ii) filmed entertainment and (iii) consumer products. Michael D. Eisner, petitioner's chairman and chief executive officer who joined petitioner in 1984, in a letter dated December 4, 1993 to shareholders and fellow Disney employees included in petitioner's 1993 fiscal year annual report, noted that:

> Disney is a global entertainer. We started as entertainers, we prospered as entertainers and we intend to continue as entertainers. We think Mickey, 'The Great Entertainer,' is a description as apt for the Disney Company as it is for the great mouse.

2. Within its consumer products business segment, petitioner licenses and distributes the name of Walt Disney, its animated character likenesses, its visual and literary properties and its songs and music to various manufacturers, retailers, show promoters and publishers throughout the world. Its licensing activities generate royalties which are usually based on a fixed percentage of the wholesale or retail selling price of the licensee's products. Merchandise categories which have been licensed include: apparel, toys, gifts, housewares, stationery, and domestic items such as sheets and towels. Publication

categories which have been licensed include: books, comic books, magazines and newspaper comic strips. Further, the Walt Disney name and characters have been used in major promotions involving soft drinks, photographic products and fast-food restaurants, among others. The negotiation of domestic license agreements was performed by account supervisors based in petitioner's California and New York offices although all domestic payments pursuant to licensing agreements were sent to petitioner's billing department located in California. Further, all protection, registration and accounting activity with respect to the Disney characters was performed by petitioner's employees located in California. Employees of petitioner's legal department, who were located in California, drafted sample license agreements, which were updated every two to three years.

3. As an example, pursuant to a license agreement between The Walt Disney Company and Dundee Mills, Inc. of Griffin, Georgia dated May 20, 1991 consisting of 28 pages, characters from the motion picture Bambi were licensed for a principal term of two and one-half years with a one year renewal option. The licensee was granted the following right:

> In consideration for your promise to pay and your payment of all Royalties, Advances and Guarantees required hereunder, we grant you the non-exclusive right, during the Principal Term and any extension thereof and only within the Territory, to reproduce the Licensed Material only on or in connection with the Articles, to use the Trademarks, but only such Trademarks and uses thereof as may be approved when the Articles are approved and only on or in connection with the Articles, and to manufacture, distribute for sale and sell (other than by direct marketing methods, including but not limited to direct mail and door-to-door solicitation) the Articles. You will sell the Articles only to retailers for sale to the public in the Territory or to wholesalers for resale to such retailers.

The licensee was authorized to use or reproduce the Bambi characters on or in 33 specified types of articles ranging from blankets and sheets to curtains and baby booties. In exchange, petitioner would be paid nine percent of the licensee's net invoiced billings on sales up to $10,000,000.00 and nine and

one-half percent of net invoiced billings on sales exceeding $10,000,000.00. With respect to articles sold outside "the Territory," petitioner would receive thirteen percent of net invoiced billings on sales up to $10,000,000.00 and thirteen and one-half percent of net invoiced billings on sales exceeding $10,000,000.00. The agreement defined "net invoiced billings" as follows:

> [A]ctual invoiced billings for Articles sold less volume discounts and other customary discounts, other than allowances or discounts relating to advertising, which have been deducted from the normal selling price. Net Invoiced Billings shall not include invoiced charges for transportation of Articles within the Territory and taxes on the sale. No costs incurred in manufacturing, importing, selling or advertising the Articles shall be deductible from your billing price for Royalty calculation purposes, nor shall any deduction be made for uncollectible accounts. The sums which we are paid as Royalties on any sales to customers affiliated with you shall be no less than the sums paid on sales to customers not affiliated with you.

The agreement defined the "Territory" as follows:

> [T]he United States, United States PX's wherever located, and United States territories and possessions, excluding Puerto Rico. However , if sales are made to chain stores in the United States which have stores in Puerto Rico, such chain stores may supply Articles to such stores in Puerto Rico.

4. During the years at issue, petitioner's royalty income[3] from its licensing activities was as follows:

[3] Included in a schedule prepared by petitioner and marked into the record as part of its Exhibit "4" are amounts representing Disney's "intangible royalty income." Such amounts vary from the "historical financial data" shown in petitioner's Exhibit "26" representing Disney's world-wide revenues from its licensing activities. If the licensing revenue from Tokyo Disneyland is excluded, there is less discrepancy between such amounts. Nonetheless, there is no explanation in the record for the variance.

Year	Intangible royalty income shown in petitioner's Exh. "4"	Historical financial data for Disney's income from licensing activities shown in Exh. "26"	Historical financial data from Exh. "26" less licensing fees from Tokyo Disneyland[4]
1990	$230,748,000	$280,219,000	$228,025,000
1991	259,942,250	319,318,000	264,246,000
1992	349,498,500	429,504,000	361,775,000
1993	452,240,250	559,889,000	461,621,000
1994	561,525,500	688,669,000	606,290,000
1995	644,962,000	789,537,000	697,597,000

Petitioner included the following royalty *receipts* in its "everywhere sales" for purposes of calculating its New York receipts factor on its New York tax returns, in contrast to the amounts shown above for royalty *income*:

	1990 fiscal year	1991 fiscal year	1992 fiscal year	1993 fiscal year	1994 fiscal year	1995 fiscal year
Petitioner's royalty receipts	$414,642,556	$474,962,049	$657,861,079	$696,790,088	$798,437,735	$771,445,921

5. Petitioner allocated royalty receipts from its licensing activities to New York, on its tax returns as filed with the state, as follows:

	1990 fiscal year	1991 fiscal year	1992 fiscal year	1993 fiscal year	1994 fiscal year	1995 fiscal year

[4] A Japanese company owns Tokyo Disneyland and has a contractual relationship with petitioner to pay royalties for the use of the Disney characters and everything else related to Disney.

Petitioner's royalty receipts allocated to New York on tax returns as filed	$23,742,636	$22,215,291	$31,532,025	$43,193,358	$57,550,073	$60,390,017

On its tax returns as filed, petitioner allocated royalty receipts to New York if the licensee, having the right to produce goods with Disney characters or brands, used a New York business location as its address in the licensing agreement. Expressed as a percentage, petitioner allocated the following percentage of its royalty receipts to New York for each of the years at issue: 1990, 5.7%; 1991, 4.7%; 1992, 4.8%; 1993, 6.2%; 1994, 7.2%, and 1995, 7.8%. Petitioner now seeks to allocate a lesser amount of its royalty receipts to New York based upon an analysis of where the goods with Disney character or brands were manufactured since many licensees with a New York business address actually manufactured such goods outside of New York in China and other low-wage areas of the world. As a result, petitioner now claims that a substantially reduced amount of its royalty receipts should be allocated to New York based upon the lesser amount of licensed goods manufactured at New York based factories as follows:

	1990 fiscal year	1991 fiscal year	1992 fiscal year	1993 fiscal year	1994 fiscal year	1995 fiscal year
Petitioner's royalty receipts reallocated to New York based on manufacturing of licensed goods in New York	$6,473,559	$8,286,707	$11,470,810	$11,344,915	$14,648,861	$21,222,322

Expressed as a percentage, petitioner now seeks to allocate the following percentage of its royalty receipts to New York for each of the years at issue: 1990, 1.6%; 1991, 1.7%; 1992, 1.7%; 1993, 1.6%; 1994, 1.8%, and 1995, 2.8%. According to petitioner, if its royalty receipts are allocated to New York based upon the location where licensed goods are manufactured, rather than the business location of the licensee, the New York numerator for petitioner's New York receipts factor would be reduced by the following amounts representing manufacturing done outside New York by licensees with New York business locations:

	1990 fiscal year	1991 fiscal year	1992 fiscal year	1993 fiscal year	1994 fiscal year	1995 fiscal year
Manufacturing done outside New York by licensees with New York addresses	$17,269,037	$13,928,584	$20,061,215	$31,848,443	$42,901,212	$39,167,695

6. Also within its consumer products business segment, petitioner has direct retail distribution through (i) its retail Disney Stores located in various cities across the United States, which the company once operated only in its theme parks, but as of September 30, 1990 it operated 69 stores in the United States and as of the end of 1993 it operated 258 worldwide, and (ii) through its three consumer catalogs, i.e., Disney, Childcraft and Just for Kids catalogs. The stores carry a wide variety of Disney merchandise and promote other businesses of the company. Complementing the retail distribution through the stores, petitioner is a direct marketer of children's educational toys, play equipment and furniture through the catalogs.[5] The stores and catalogs sell similar and, at times, the same products.[6]

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[5] Petitioner has argued that the merchandise sold through its Childcraft and Just for Kids catalogs was distinct from the Disney-related merchandise marketed through Disney catalogs. However, this distinction is not

During the year immediately preceding the years at issue, the direct mail operation of The Walt Disney Catalog and Childcraft sent more than 40,000,000 catalogs to the nation's homes clearly making petitioner one of the largest direct marketers of products for families with children. A schedule included in the audit papers shows the sales of the Walt Disney Catalog throughout the United States for fiscal year 1992 of $14,923,346.00. Its California destination sales top the list with sales of $1,918,868.00 or 12.8582%, with New York destination sales, a close second, with sales of $1,569,580.00 or 10.5176%. The third highest amount of sales were Pennsylvania destination sales of $1,044,820.00 or 7.0012%. The record discloses the business allocation percentages to New York for The Disney Store for some[7] of the years at issues as follows:

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made in its form 10-K annual reports which in fact suggest that there is an overlapping at times of the merchandise marketed through the three types of catalogs. Further, the annual report for 1990 refers to Childcraft Inc. as petitioner's direct mail subsidiary, and noted that it mailed 45 million Disney, Childcraft and Just for Kids! Catalogs in 1990, blurring the catalog operations together. Similarly, the 1992 annual report referred to Childcraft Inc. as "Disney's catalog marketing subsidiary." Finally, in 1990 during an earlier audit of the three fiscal years 1987-1990, the Division's auditor was told by Disney people that the Disney catalog was run through the Childcraft management.

[6] Petitioner's primary factual witness, Karen Mbanefo, was not certain concerning the products sold but eventually in the course of her response to questioning conceded that some of the same products were sold at the stores and in the catalogs. Her testimony reflected a desire to hedge her response:

> Administrative Law Judge ("ALJ"): Now, do you have any knowledge of the merchandise sold at Disney's retail stores?
> Ms. Mbanefo: Yes.
> ALJ: [D]id that merchandise [in the stores] overlap with merchandise sold in the catalogs? Do you know?
> Ms. Mbanefo: By overlap, do you mean did they have similar products or the same products?
> ALJ: Let's first say similar products. Were there similar products?
> Ms. Mbanefo: Yes. There were similar products.
> ALJ: Were . . . there products that were the same at the stores and in the catalogs?
> Ms. Mbanefo: I can speak currently. I really don't know what it was like during the audit period.
> Yes. There are some of the same items. You can buy the same videos. You can buy the same plush toys. So, yes, there are some of the same items.

[7] These percentages were reported on separate New York reports of The Disney Store included with petitioner's respective combined report. Separate reports for The Disney Store for some of the years at issue were not included in the record.

	1991 fiscal year	1992 fiscal year	1993 fiscal year	1994 fiscal year
Business allocation percentage to New York	5.7264%	6.1189%	5.7211%	5.9945%

7. Within its theme parks and resorts business segment, petitioner owns and operates the Disneyland theme park, Disneyland Hotel and other attractions in California and the Walt Disney World destination resort in Florida. The Walt Disney World destination resort includes the Magic Kingdom, Epcot Center, the Disney-MGM Studios theme park, hotels and villas, a nighttime entertainment complex, shopping villages, a conference center, campgrounds, golf courses and other recreational facilities. Petitioner earns royalties on revenues generated by the Tokyo Disneyland theme park near Tokyo, Japan, which is owned and operated by an unrelated Japanese corporation. Petitioner is an equity investor in Euro Disneyland near Paris, France.

8. Within its filmed entertainment business segment, petitioner produces and acquires live action and animated motion pictures for distribution to the theatrical, television and home video markets. Petitioner, in its 1992 annual report, noted that “we pioneered the concept of selling videos directly to the consumer.” Petitioner’s film library as of September 30, 1989, just prior to the audit period at issue, included approximately 181 full-length live-action (primarily color) features, 27 full-length animated color features and approximately 500 cartoon shorts. At the beginning of the audit period according to the fiscal year 1990 Form 10-K annual report, approximately 211 titles, including 56 feature films and 100 cartoons and animated features, were available to the “home entertainment

market" including many of the top-20 all-time home video bestsellers.[8] At the end of the audit period according to the fiscal year 1995 Form 10-K annual report, approximately 657 titles, including 203 feature films and 193 cartoon shorts and animated features were available to the domestic marketplace. Furthermore, by the end of the audit period, petitioner's subsidiary, Walt Disney Pictures and Television, was producing, acquiring, and distributing live-action motion pictures under the banners Walt Disney Pictures, Touchstone Pictures, Hollywood Pictures and Caravan Pictures as well as distributing films produced or acquired by independent production companies, Cinergi Pictures Entertainment, Interscope Communications and Merchant-Ivory Productions. Petitioner's Miramax Film Corp. subsidiary distributes films under its own banner. Petitioner also produces original television product for network and first-run syndication markets. Petitioner distributes its filmed product through its own distribution and marketing companies in the United States. Petitioner invests in programming for and operates The Disney Channel, a pay television programming service, which by the end of the audit period had 14.5 million subscribers, and a Los Angeles television station. Further, by the end of the audit period, petitioner had branched out into theatrical productions with the production in 1994 of a Broadway-style stage musical based on the animated feature film Beauty and the Beast.

9. Although petitioner, as noted in Finding of Fact "1", may be viewed as having operations in three business segments, the concept of synergy or "cooperative energy" undergirds petitioner's approach to business. The parent company's Synergy Group helps bring together and coordinate all business segments when developing a new product or idea. In fact, each business unit in the Disney

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[8] According to the 1993 annual report, The Walt Disney Studios has produced the top 5 all-time best-selling domestic home video titles (1, Aladdin; 2, Beauty and the Beast; 3, 101 Dalmatians; 4, Fantasia; and 5, Pinocchio)and 14 of the top 20.

combined group has a synergy representative who meets with the Synergy Group in order to coordinate marketing efforts. In addition, a large part of the operation of The Walt Disney Company, the parent entity, centers around the provision of administrative services to its affiliated companies at cost to ensure the integration of this cooperative energy into the enterprise.

Further, cross-promotion of the activities of sister entities is a Disney standard operating procedure. For example, the fiscal year 1993 annual report noted:

> Capitalizing on the concept of synergy, The Disney Stores supported the activities and products of other Disney divisions through the *extensive* use of promotions, displays and in-store videos. (Emphasis added.)

Another example is contained in the fiscal year 1992 annual report which noted that The Little Mermaid was named "License of the Year" for 1992, "three years into her career" making revenue from licensed consumer goods as important as revenue from the film itself. Further, the 1992 report noted how the animated film, Aladdin, had opened triumphantly and that "In Consumer Products, Aladdin has already racked up the biggest merchandise push of any Disney animated film ever, with a vast array of products targeted for girls, boys and adults."

In fact, as far back as 1958, synergy or the integration or cross-promotion of its three business segments has been a driving force and viewed as "a natural resource" within the company. Roy Disney, the president of The Walt Disney Company in 1958 and Walt Disney's brother, describing the enterprise's formula for success, stated:

> Integration is the key word around here. We don't do anything in one line without giving a thought to its likely profitability in our other lines.

During the years at issue and up to the present, petitioner's theme parks have been a showcase for Disney synergy efforts through the use of attractions and displays which promote Disney films and television shows, the sale of licensed merchandise, appearances in-park by Disney celebrities, etc. In petitioner's own words, included in its request for permission to file a combined report dated October 29, 1993, each link in the Disney chain helps support the other, and in turn, increases the level of success for the entire company. Petitioner summed up the value of this intangible resource in its request to file a combined report for 1996, the year immediately following the period at issue, as follows:

> The benefits of this intangible synergy permeate virtually all of the inextricably connected entities and have been present since the early days of the Company. There is substantial value gained by each of the entities by virtue of its relationship with the Walt Disney affiliated group. Indeed, the mere association of an affiliated entity with The Walt Disney Group gives the entity an edge in the marketplace. No intercompany charge is imposed for the synergistic association due in part to the inherent inability to objectively value this association. Even where charges are imposed for use of a Disney name, trademark, or copyright, distortion may be present due to the added value gained by an affiliate's association with the entire Disney Group.

10. Petitioner's "entire company revenues" for the fiscal years at issue, as noted in its annual reports, were as follows:

Revenues (in millions)	1990	1991	1992	1993	1994	1995
Consumer products	573.8	724.0	1,081.9	1,415.1	1,798.2	2,150.8
Filmed entertainment	2,250.3	2,593.7	3,115.2	3,673.4	4,793.3	6,001.5
Theme parks & resorts	3,019.6	2,794.3	3,306.9	3,440.7	3,463.6	3,959.8
Totals	5.84 billion	6.11 billion	7.50 billion	8.53 billion	10.06 billion	12.11 billion

11. Petitioner's "operating income" for the fiscal years at issue, as noted in its annual reports, was as follows:

Income (in millions)	1990	1991	1992	1993	1994	1995
Consumer products	223.2	229.8	283.0	355.4	425.5	510.5
Filmed entertainment	313.0	318.1	508.3	622.2	856.1	1,074.4
Theme parks & resorts	889.3	546.6	644.0	746.9	684.1	860.8
Totals	1.43 billion	1.09 billion	1.44 billion	1.72 billion	1.97 billion	2.45 billion

12. Petitioner filed combined reports in the parent corporation's name, i.e., The Walt Disney Company, with a varying number of subsidiaries, during the years at issue. For fiscal years 1990, 1991, and 1992, the following eight subsidiaries were included in petitioner's New York combined report: (1) Walt Disney Pictures & Television; (2) Buena Vista Pictures Distribution; (3) Buena Vista International; (4) Buena Vista Television; (5) Disney Educational Productions; (6) Walt Disney Music Company; (7) Wonderland Music Company, Inc.; and (8) Canasa Trading Corp.

13. By a Request for Permission to File a Combined Report or to Change an Existing Combined Group dated October 29, 1993 (Exhibit "FFFFFFF"), a request for permission to add additional corporations to the existing combined group detailed in Finding of Fact "12" was submitted by The Walt Disney Company for the approval by the Division of Taxation ("Division"). The existing combined group consisting of The Walt Disney Company and the eight subsidiaries noted above was determined by the Division during an earlier audit of The Walt Disney Company's fiscal years, 1974 through 1982. As of the end of the fiscal year 1992, only the parent corporation and these same eight subsidiaries, out of a total of approximately 165 active domestic entities included in the Disney federal

affiliated group, were included in the New York combined group. But by this request in 1993, The Walt Disney Company sought permission "to file a combined report including *all members of its federal consolidated group* since it satisfies the requirements to file such a report (emphasis added)." In a succinctly stated "Conclusion," The Walt Disney Company summarized the basis for its request as follows:

> [A]ll entities in the Disney federal consolidated group should be included in the New York combined return because they satisfy the stock ownership, unitary business and distortion requirements for filing a combined report.
>
> As stated previously, all entities in the consolidated federal affiliated group are directly or indirectly 100 percent owned subsidiaries.
>
> All entities are involved in unitary entertainment and related businesses. In fact, two entities (i.e. Walt Disney World Co. and Lake Buena Vista Communities, Inc.) currently excluded from the group conduct theme park operations which have historically been a substantial portion of the same business conducted by the Parent company. In addition, Walt Disney World Co. owns a fully operational motion picture and television production studio but is not included in the combined group whereas Walt Disney Pictures and Television, Inc. and the other filmed entertainment companies are so included.
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> Filing New York returns including only the current combined group members results in a distortion of the taxpayer's activities, business, income or capital in the State. As previously stated, no interest is charged on most intercompany loans. Many entities service other Disney companies exclusively. In many situations their goods and services are provided without profit. Even in cases where the companies charge for their products or services, such charges may not adequately reflect the value of the Disney trademark, copyright and management.
>
> *The businesses of The Walt Disney Company and all its U.S. subsidiaries are so unified and interrelated that a proper reflection of their New York franchise tax liability is impossible without combination.* A combined report including all the members of the Disney affiliated group will more accurately reflect the extent of business conducted within New York. (Emphasis added.)

14. By a letter dated January 14, 1994, the Division granted tentative permission to The Walt Disney Company to include the long list of subsidiaries listed in its request with a few minor exceptions. Consequently, for fiscal year 1993, the eight subsidiaries noted above were again included in petitioner's New York combined report *plus* the following 97 subsidiaries[9]: (1) Agarita Music, (2) Animation Collectors, Inc., (3) Axman Realty Corp., (4) Berl Holding Co., (5) Billy B. Productions, Inc. (6) Bird-In-Hand Woodworks, Inc., (7) Bonnie View Productions, Ltd., (8) Boss Realty, Inc. (9) Buena Vista Communications, (10) Buena Vista Entertainment, Inc., (11) Buena Vista Home Video, (12) Buena Vista Media, (13) Buena Vista Productions, (14) Buena Vista Theatres, Inc., (15) Buena Vista Worldwide Services, Inc., (16) BVCC, Inc., (17) Childcraft, Inc., (18) Childcraft Education Corp., (19) Club 33, (20) Commercial Apartment Properties, Inc., (21) Compass Rose Corp., (22) Devonson Corp., (23) Disney Art Editions, Inc., (24) Disney Book Publishing, Inc., (25) Disney Character Voices, Inc. (26) Disney Consumer Products Int'l, Inc., (27) Disney Development Co., (28) Disney Direct Marketing Services, Inc., (29) Disney Direct Response Publishing, Inc., (30) Disney, Inc., (31) Disney International Employment Services, Inc., (32) Disney Magazine Publishing, Inc., (33) Disney Vacation Club Management Corp., (34) Disney Vacation Development, Inc., (35) Disney Worldwide Services, Inc., (36) Disneyland, Inc., (37) Disneyland International, (38) Dutchman Realty, Inc., (39) Earth Star, Inc., (40) EDL Holding Co., (41) EDL S.N.C. Corp, (42) Entertainment Development, Inc., (43) Euro Disney Corp., (44) Faded Denim Productions Ltd., (45) Falferious Music, (46) Fidelity Television, Inc., (47) Film Brothers Property Corp., (48) From Time to Time, Inc.,

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[9] As noted in footnote "18", the parties stipulated to the subsidiaries included in petitioner's combined reports. A review of the reports in the record shows that the subsidiary Wonderland Music Co., was included in the reports for 1993, 1994, and 1995 as it was for the earlier years at issue, although the stipulation did not so provide.

(49) Hardware Distribution, Inc., (50) Harvest Groves, Inc., (51) Hodi Investments, Inc., (52) Hollywood Records, Inc., (53) Holpic Music, Inc., (54) Homestead Homes, Inc., (55) Hughes Flying Boat Corp., (56) KCAL-TV, Inc., (57) Kelly Management, Inc., (58) KHJ-TV, Inc., (59) Lake Bryan, Inc., (60) Lake Buena Vista Communities, Inc., (61) Madeira Land Co., Inc., (62) Magnolia Creek Development Co., (63) Maple Leaf Commercial Properties, Inc., (64) Miramax Film Corp., (65) One For All Productions, Inc., (66) Palm Financial Services, Inc., (67) Pine Woods Properties, Inc. (68) Ranch and Grove Holding Corp., (69) Reedy Creek Energy Services, Inc., (70) Stakeout Two Productions, Inc., (71) The Disney Channel, (72) The Disney Publishing Group, (73) The Disney Store, Inc., (74) The Dolphin Hotel, Inc., (75) The Little Lake Bryan Co., (76) The Swan Hotel, Inc., (77) The Walt Disney Catalog, (78) Theme Park Productions, Inc., (79) Toon Town, Inc., (80) Touchstone Pictures Music & Songs, Inc., (81) Touchstone Songs, (82) Touchwood Pacific Partner 1, Inc., (83) Voice Quality Coordination, Inc., (84) Walt Disney Asia, Inc., (85) Walt Disney Attractions, (86) Walt Disney Computer Software, Inc., (87) Walt Disney Feature Animation Florida, Inc., (88) Walt Disney Imagineering, (89) Walt Disney Theatrical Productions Ltd., (90) Walt Disney Travel Co., Inc., (91) Walt Disney World Co., (92) WCO Hotels, Inc., (93) WCO Leisure, Inc., (94) WCO Parent Corp., (95) WCO Port Management Corp., (96) WCO Port Properties, Ltd., and (97) WCO Vacationland, Inc.

The eight subsidiaries[10] included in petitioner's New York combined reports for each of the earlier years of 1990, 1991, and 1992 were again included in a combined report for fiscal year 1994.

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[10] A review of the fiscal year 1994 combined report in the record shows that the subsidiary, Canasa Trading Corp., was again included, as it was for the earlier years at issue although the stipulation of the parties, as noted in footnote "18" did not so provide.

In addition, all of the 97 subsidiaries included in the combined report for fiscal year 1993, as listed above, were again included in the report for 1994 except for the following 13 entities which were not so included: (1) Axman Realty Corp., (2) Berl Holding Co., (3) Billy B. Productions, Inc., (4) Boss Realty, Inc., (5) Buena Vista Communications, (6) Devonson Corp., (7) Dutchman Realty, Inc., (8) Entertainment Development, Inc., (9) Fidelity Television, Inc., (10) Hodi Investments, Inc., (11) Kelly Management, Inc., (12) One For All Productions, Inc., and (13) Ranch and Grove Holding Corp. Further, the following 37 additional subsidiaries were included in the combined report for fiscal year 1994, which had not been included in the earlier years at issue: (1) 2139 Empire Avenue Corp., (2) Alameda Payroll, Inc., (3) Andes Productions, Inc., (4) Blue Note Management Corp., (5) Buena Vista Catalogue Co., (6) BVHV Services, (7) C.A. Productions, Inc., (8) DCSR, Inc., (9) Disney Comics, Inc., (10) Disney Computer Magazine Group, Inc., (11) Disney Keystone Properties, Inc., (12) Disney Realty, Inc., (13) Disney Sports Enterprises, Inc., (14) ERS Investment Ltd., (15) Euro Disney Investments, Inc., (16) Heavy Weight, Inc., (17) Holmes Houses, Inc., (18) Indian Warrior Productions, Inc., (19) Key Bridge Properties, Inc., (20) LBV Services, Inc., (21) Miramax Film Partners, Inc., (22) Miramax Productions, Inc., (23) Montrose Corp., (24) Palm Hospitality Co., (25) PNLH Payroll Inc., (26) Skellington Productions, Inc., (27) Supercomm International, Inc., (28) Swing Kids Productions, Inc., (29) The Celebration Co., (30) The Disney Childrens' Center, Inc., (31) TWDC (India), Inc., (32) Valleycrest Productions Ltd., (33) Walt Disney Properties Corp., (34) Walt Disney Theatrical Worldwide, Inc., (35) Wanderlust Productions, Inc., (36) WDT Services, Inc., and (37)WDW Services, Inc.

The eight subsidiaries included in petitioner's New York combined reports for each of the earlier years of 1990, 1991, and 1992 were again included in a combined report for fiscal year 1995. In addition, all of the 97 subsidiaries included in the combined report for fiscal year 1993, as listed above, were again included in the report for 1995 except for the following 27[11] entities which were not so included: (1) Axman Realty Corp., (2) Berl Holding Co., (3) Billy B. Productions, Inc., (4) Bonnie View Productions, (5) Boss Realty, Inc., (6) Buena Vista Communications, (7) Buena Vista Entertainment, (8) Devonson Corp., (9) Disney Character Voices, Inc., (10) Dutchman Realty, Inc., (11) Entertainment Development Inc., (12) Faded Denim Productions, (13) Fidelity Television, Inc., (14) From Time to Time, Inc., (15) Harvest Groves, Inc., (16) Hodi Investment Inc., (17) Hughes Flying Boat Corp., (18) Kelly Management Inc., (19) Magnolia Creek Development Co., (20) One For All Productions, Inc., (21) Palm Financial Services, Inc., (22) Stakeout Two Productions, Inc., (23) The Swan Hotel, Inc., (24) Toon Town, Inc., (25)Walt Disney Asia, Inc., (26) Walt Disney Computer Software, Inc., (27) WCO Port Management Corp. As noted above, there were also 37 additional subsidiaries included in the combined report for fiscal year 1994 which had not been included in the earlier years at issue. The combined report for fiscal year 1995 included only 23 of these 37 additional subsidiaries and did not include the following 14: (1) Alameda Payroll, Inc., (2) Andes

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[11] For 1994, as noted above, 13 entities included in the combined report for fiscal year 1993 were not included in the report for 1994. For 1995, 12 of these 13 entities were also not included in the combined report for 1995. However, Ranch and Grove Holding Corp. which was included in the combined report for fiscal year 1993, but not for 1994, was included in the report for 1995. Further, the following 15 entities which were included in the 1993 and 1994 combined reports were *not* included in the 1995 combined report: (1) Bonnie View Productions, (2) Buena Vista Entertainment, (3) Disney Character Voices, Inc., (4) Faded Denim Productions, (5) From Time to Time, Inc., (6) Harvest Groves, Inc., (7) Hughes Flying Boat Corp., (8) Magnolia Creek Development Co., (9) Palm Financial Services, Inc., (10) Stakeout Two Productions, (11) The Swan Hotel, Inc., (12) Toon Town, Inc., (13) Walt Disney Asia, Inc., (14) Walt Disney Computer Software, Inc., and (15) WCO Port Management Corp.

Productions, Inc., (3) Buena Vista Catalog Co., (4) BVHV Services, (5) C.A. Productions, Inc., (6) Disney Realty, Inc., (7) Heavy Weight, Inc., (8) Indian Warrior Productions, Inc., (9) Miramax Film Partners, Inc., (10) Miramax Productions, Inc., (11) Skellington Productions, Inc., (12) Swing Kids Productions, Inc., (13) Valleycrest Productions, Ltd., (14) Wanderlust Productions, Inc. Finally, the combined report for fiscal year 1995 included the following 28 additional subsidiaries which had not been included in the earlier years at issue: (1) Alameda Paying Agent, Inc., (2) Buena Vista Theatrical Ventures, Inc., (3) Before & After Productions, Inc., (4) Buena Vista Laboratories, Inc., (5) Buena Vista Music Co., (6) Buena Vista Trading Co., (7) Destination Disney, Inc., (8) Disney Cruise Line, Inc., (9) Disney Interactive, Inc., (10) Disney Interfinance Corp., (11) Disney Media Ventures, Inc., (12) Disney Music Publishing, (13) Disney Special Programs, Inc., (14) Disney Televentures, Inc., (15) Disney Television (Germany), Inc. (16) Hollywood Pictures Music, (17) IJR, Inc., (18) J.B. Productions, Inc., (19) Merriweather Productions, Inc., (20) New Amsterdam Development Corp., (21) New Amsterdam Theatrical Productions, Inc., (22) Plymouth Productions, (23) RCE Services, Inc., (24) Seven Peaks Music, (25) Seven Summits Music, (26) The Inn Corp. (27) The Quiz Show Co., and (28) Wizzer Productions, Inc.

15. Petitioner and the Division stipulated that in addition to the parent organization, The Walt Disney Co., the following Disney subsidiaries were New York taxpayers and subject to the imposition of New York corporation franchise tax under Article 9-A during the years at issue. For each of the fiscal years, 1990, 1991 and 1992, these 12 Disney subsidiaries were New York taxpayers: (1) Childcraft Education Corp., (2) Disney Book Publishing, Inc., (3) Disney Magazine Publishing, Inc., (4) Hollywood Records Inc., (5) KHJ-TV Inc., (6) The Disney Channel, (7) The Disney Store, Inc., (8)

Walt Disney Attractions, (9) Buena Vista Pictures Distribution, Inc., (10) Buena Vista Television, (11) Disney Educational Productions, and (12) Walt Disney Pictures & Television.

For fiscal year 1993, the above 12 subsidiaries except for the following 2 were New York taxpayers: (1) Walt Disney Attractions, and (2) Disney Educational Productions; plus the following 5 Disney subsidiaries were New York taxpayers and subject to Article 9-A during 1993: (1) Buena Vista Productions, (2) Canasa Trading Corp., (3) Disney Worldwide Services, Inc., (4) Miramax Film Corp., and (5) Walt Disney Imagineering.

For fiscal year 1994, the 12 subsidiaries listed for each of the fiscal years, 1990, 1991 and 1992, except for the following 4 were New York taxpayers: (1) Walt Disney Attractions, (2) Disney Educational Productions, (3) Disney Book Publishing, Inc. and (4) KHJ-TV, Inc.; plus the 5 additional Disney subsidiaries noted above for 1993; plus 4 more Disney subsidiaries were New York taxpayers: (1) Book Publishing, Inc.,[12] (2) Disney Sports Enterprises, Inc., (3) KCAL-TV, Inc., and (4) Walt Disney Theatrical Productions, Ltd.

For fiscal year 1995, the 12 subsidiaries listed for each of the fiscal years, 1990, 1991, and 1992, except for the following 2 were New York taxpayers: (1) KHJ-TV, Inc., and (2) Disney Educational Productions; plus the 5 additional Disney subsidiaries noted above for 1993 except for the following 2: (1) Canasa Trading Corp., and (2) Disney Worldwide Services, Inc.; plus the 4 additional Disney subsidiaries noted above for 1994 except for the following 2: (1) Book Publishing, Inc. and (2) Disney Sports Enterprises, Inc.; plus 4 more Disney subsidiaries were New York taxpayers: (1) Buena

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[12] It is not known whether Book Publishing, Inc., in fact, is the same entity as Disney Book Publishing, Inc. Consequently, it has been noted above as an additional subsidiary which the parties have agreed may be treated as a New York taxpayer in 1994 and, in turn, Disney Book Publishing, Inc. has been noted above as not so included.

Vista Theatrical Ventures, Inc., (2) Disney Direct Response Publishing, Inc., (3) Film Brothers Property Corp., and (4) Wizzer Productions, Inc.

16. For the years at issue, petitioner computed its New York corporation franchise tax liability based upon a "combined entire net income base tax computation" as follows:

	1990	1991	1992	1993	1994	1995
Combined entire net income	$470,114,109	$587,333,657	$566,771,423	$749,361,137	$599,278,568[13]	$913,149,855
Business income allocated to NY	11,361,280	17,126,717	12,170,894	9,525,374	11,092,893	18,950,577
Tax	$1,022,515	$1,541,405	$1,267,010	$988,641	$1,188,040	$1,787,137

Petitioner allocated its business income to New York, as noted above, based upon the following business allocation percentages:

Year	Business Allocation Percentage to New York
1990	2.4167%
1991	2.7325%
1992	2.7649%
1993	1.6292%
1994	2.3614%
1995	2.1977%

[13] The photocopy of the 1994 return is poor and this amount is a "best guess."

These business allocation percentages were computed by petitioner as follows:

	1990	1991	1992	1993	1994	1995
1. New York property	$ 35,550,536	$ 52,809,330	$ 64,382,261	$ 137,443,511	$ 203,466,343	$ 225,645,524
2. Property every where	2,229,788,942	3,331,097,532	3,986,873,865	13,394,011,550	16,214,201,757	19,052,101,594
3. Combined New York property factor (line 1 ÷ line 2)	1.5943%	1.5853%	1.6149%	1.0262%	1.2549%	1.1844%
4. New York receipts	72,323,674	75,048,533	103,689,758	159,061,860	238,228,662	271,775,432
5. Receipts every where	2,286,037,711	2,509,209,326	3,345,627,697	8,330,446,811	9,234,049,932	10,815,381,768
6. Combined New York receipts factor (line 4 ÷ line 5)	3.1637%	2.9909%	3.0993%	1.9094%	2.5799%	2.5129%
7. Addition-al receipts factor	3.1637%	2.9909%	3.0993%	1.9094%	2.5799%	2.5129%

8. New York State wages	8,191,969	16,459,068	16,953,470	27,654,710	52,797,015	52,467,026
9. Wages every where	469,438,633	489,451,335	522,252,645	1,654,422,595	1,741,978,124	2,033,215,511
10. Combined New York payroll factor (line 8 ÷ line 9)	1.7451%	3.3628%	3.2462%	1.6716%	3.0309%	2.5805%
11. Total New York State factors (add lines 3, 6, 7, 10)	9.6668%	10.9299%	11.0597%	6.5166%	9.4456%	8.7907%
12. Combined business allocation percent-age (line 11 ÷ 4)	2.4167%	2.7325%	2.7649%	1.6292%	2.3614%	2.1977%

17. For its 1990 fiscal year, Buena Vista Home Video, was not one of the eight subsidiaries of Disney Enterprises, Inc. included in petitioner's New York combined report, but rather it filed a separate New York corporation franchise tax return on which it reported a fixed dollar minimum tax due of $1,500.00. It reported a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) on the basis of "no nexus under Public Law 86-272," it reported none of

its $662,038,872.00 gross receipts as “sales of tangible personal property shipped to points within New York” although, of course, it had large sales of tangible personal property shipped to points within New York.

For its 1991 fiscal year, Buena Vista Home Video filed similarly on a separate New York corporation franchise tax return and reported a fixed dollar minimum tax due of $1,500.00. Again, it reported a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) on the basis of “no nexus under Public Law 86-272,” it reported none of its $989,510,226.00 gross receipts as “sales of tangible personal property shipped to points within New York State” although it had large sales of tangible personal property shipped to points within New York.

Similarly, for its 1992 fiscal year, Buena Vista Home Video filed a separate New York corporation franchise tax return and reported a fixed dollar minimum tax due of $1,500.00. Again, it reported a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) it reported none of its $1,372,034,743.00 gross receipts as “sales of tangible personal property shipped to points within New York State” although it had large sales of tangible personal property shipped to points within New York. For fiscal year 1992, this Disney subsidiary did not specifically note on its return its claim of “no nexus under Public Law 86-272.”

For the 1993 fiscal year, Buena Vista Home Video was included in petitioner’s combined New York corporation franchise tax return on which it reported a subsidiary fixed dollar minimum tax of $1,500.00. On its own form CT-3 filed along with the combined report, it again reported a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) it reported none of its $1,450,727,704.00 gross receipts as “sales of tangible personal property shipped to points

within New York State" although it had large sales of tangible personal property shipped to points within New York.

For the 1994 fiscal year, Buena Vista Home Video was again included in petitioner's combined New York corporation franchise tax return on which it reported a subsidiary fixed dollar minimum tax of $1,500.00. On its own form CT-3 filed along with the combined report, it continued to report a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) it reported none of its $1,802,840,975.00 gross receipts as "sales of tangible personal property shipped to points within New York State" although it had large sales of tangible personal property shipped to points within New York.

For the 1995 fiscal year, Buena Vista Home Video was also included in petitioner's combined New York corporation franchise tax return on which it reported a subsidiary fixed dollar minimum tax of $1,500.00. On its own form CT-3 filed along with the combined report, Buena Vista Home Video continued to report a New York allocation percentage of 0% based upon (i) no wages and property in New York, and (ii) it reported none of its gross receipts of $2,456,596,414.00 as "sales of tangible perosnal property shipped to points within New York State" although it had large sales of tangible personal property shipped to points within New York.

18. For fiscal years 1990, 1991 and 1992, The Walt Disney Catalog, Inc. and Childcraft, Inc. did not file separate Article 9-A returns or as part of the Disney Group combined report.

For fiscal year 1993, Childcraft, Inc. was included in petitioner's New York combined report. On its own CT-3, filed along with the combined report, Childcraft, Inc., reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $67,190,429.00 were allotted

as sales of tangible personal property shipped to points within New York State. Further, for fiscal year 1993, The Walt Disney Catalog, Inc. was included in petitioner's New York combined report. On its own form CT-3, filed along with the combined report, The Walt Disney Catalog, Inc. reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $25,567,257.00 were allotted as sales of tangible personal property shipped to points within New York State.

For fiscal year 1994, Childcraft, Inc. was again included in petitioner's New York combined report. On its own form CT-3 filed along with the combined report, Childcraft, Inc. reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $75,082,356.00 were allotted as sales of tangible personal property shipped to points within New York State. Further, for fiscal year 1994, The Walt Disney Catalog, Inc. was included in petitioner's New York combined report, and on its own form CT-3 filed along with the combined report, The Walt Disney Catalog, Inc. reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $35,738,010.00 were allotted as sales of tangible personal property shipped to points within New York State.

For fiscal year 1995, Childcraft, Inc. was included in petitioner's New York combined report, and on its own form CT-3, filed along with the combined report, Childcraft Inc. reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $46,077,000.00 were allotted as sales of tangible personal property shipped to points within New York State. Further, for fiscal year 1995, The Walt Disney Catalog, Inc. was also included in petitioner's New York combined report, and on its own form CT-3, filed along with the combined report, The Walt Disney Catalog, Inc.

reported a business allocation percentage of 0%, and none of its sales of tangible personal property of $45,421,952.00 were allotted as sales of tangible personal property shipped to points within New York State.

19. The Division's audit of the years at issue entailed 493 total case hours over 65.73 audit days spread over a period beginning on November 4, 1997 and ending three years later on November 30, 2000. This audit of the years at issue was a successive audit to a prior audit of petitioner's three earlier fiscal years, 1987 to 1989. This earlier audit conducted in the early 1990s was closed in the auditor's words, "with a full combined report of pretty much everybody in the federal group" (tr., p. 631). However, in the course of the audit of the years at issue, the Division determined that petitioner's receipts factor used to calculate its business allocation percentage for each of the years at issue had to be adjusted "to reflect all companies[14] included in the combined report." Although petitioner calculated its entire net income for each of its fiscal years 1993, 1994, and 1995 by combining the net incomes of all the members of the combined group, it left out of the numerators of its business allocation percentages, factor values associated with Buena Vista Home Video, Childcraft, Inc. and The Walt Disney Catalog. Consequently, the Division increased the numerator, representing New York destination sales, to include the New York destination sales of these three subsidiaries despite petitioner's disagreement that these companies, which allegedly did not have nexus in the State of New York, should not have their New York receipts included in the numerator of the receipts factor. Buena Vista Home Video, which also had employees and property in New York, had adjustments made to its

[14] Petitioner agrees that Buena Home Video, Childcraft, Inc. and The Walt Disney Catalog, Inc. should be included in the combined report although it maintains, nonetheless, that their New York destination receipts should be excluded in calculating petitioner's business allocation percentage.

payroll and property factors as well. The Division also recalculated tax due in a similar fashion for the earlier fiscal years at issue for which petitioner had not filed similar combined reports.

20. Petitioner's subsidiaries, Buena Vista Home Video, Childcraft, Inc. and The Walt Disney Catalog each solicited orders of tangible personal property and conducted ancillary activities to obtain such orders for their products within New York.

21. Buena Vista Home Video, during the audit period, sold video cassettes of movies to third parties for purposes of resale. Its customers were large-scale retailers like Wal Mart and wholesalers (district or regional accounts). Buena Vista Home Video used its own employees as salespeople who traveled around New York to call on its customers' employees who made purchasing decisions, including the solicitation of sales from certain national account customers, such as Toys "R" Us, Blockbuster, and Trans World Records, which were headquartered in New York. Its salespeople, who carried samples and promotional items, did not carry inventory and were not allowed to accept orders, collect money or accept returned items. Other than the cars used by its salespeople and the samples and promotional items, Buena Vista Home Video did not store any inventory in New York, or own or rent any property in New York.

22. Buena Vista Home Video benefitted from its synergistic relationship with taxpayer members of petitioner's combined group. In particular, the Disney retail stores in New York and Buena Vista Home Video were often involved in common promotions in order to sell their products. Beyond the mention of the products sold by Buena Vista Home Video in the retail stores, including cash register displays, newsletters sent to customers of the retail stores referenced the products sold by Buena Vista

Home Video. During the fiscal years at issue, each ending on September 30th of the respective year, Buena Vista Home Video's sales into New York were as follows:

1990	1991	1992	1993	1994	1995
$26,232,999	$19,087,605	$35,722,292	$51,551,334	$55,365,858	$66,799,814

23. The Walt Disney Catalog, during the audit period, sold Disney-branded products, such as toys and clothing. It solicited sales for its products throughout New York by mailing catalogs directly to consumers and then taking orders either over the phone or through order forms mailed to the subsidiary's call centers. All of the orders were accepted at its call centers, none of which were located in New York. The Walt Disney Catalog did not use any salespeople to directly solicit sales and it did not solicit sales through trade shows. It did not have any payroll or property, including inventory, in New York during the audit period. Although it did not own any stores in New York and solicited its sales through its catalogs mailed to consumers, Disney stores located in New York sold similar products. Petitioner's chief witness, who testified concerning the activities of this subsidiary in New York, in response to a question posed by the administrative law judge, stated that she did not know if during the audit period a consumer could return an item purchased from a catalog at a Disney store located in New York. Further, like Buena Vista Home Video, The Walt Disney Catalog was also accustomed to cross-promoting its products with the retail stores operated by The Disney Store in New York. At one point, the retail stores located in New York had telephones available so that customers could order from The Walt Disney Catalog. The 1992 Disney Holiday Catalog indicated that one form of payment for a customer of The Walt Disney Catalog was the option of using their Disney Store Credit

Card. Ultimately, The Walt Disney Catalog became part of The Disney Store. During the fiscal years at issue, each ending on September 30th of the respective year, The Walt Disney Catalog's sales into New York were as follows:

1990	1991	1992	1993	1994	1995
$1,628,939	$1,776,461	$1,569,580	$3,065,671	$3,908,782	$4,705,565

24. Childcraft, Inc. was a mail-order retailer, with no stores in New York, that sold toys and clothes. During earlier periods prior to this subsidiary's acquisition by petitioner, it sold Disney-branded products and also may have sold Disney-branded products during the audit period. Given the lack of testimony from a Disney witness with personal knowledge of its operation as discussed further in the Conclusions of Law, there is some ambiguity in the record concerning the products it sold. Further, Childcraft, Inc., like The Walt Disney Catalog, solicited sales for its products by mailing catalogs directly to New York consumers and then taking orders either over the phone or through the mailing in of order forms to its call centers, none of which were located in New York. It did not use any salespeople to directly solicit sales and it did not solicit sales through trade shows. Childcraft, Inc. did not own or rent any property in New York, including inventory, and did not have any employees that performed services for it in New York during the audit period. Finally, as a mail order operation, Childcraft maintained mailing lists, and it and The Walt Disney Catalog made use of each other's lists. In fact, the record includes evidence that catalog operations were coordinated as noted in Footnote "5", and Childcraft's large and high-quality mailing lists were utilized to bolster expansion of The Walt Disney Catalog's direct mail solicitation by the mailing of catalogs to consumers on Childcraft's lists. Furthermore, Childcraft

and The Walt Disney Catalog had the same chief financial officer, Steve Finney.[15] In sum, the evidence is indicative that these two subsidiaries were run together. During the fiscal years at issue, each ending on September 30th of the respective year, Childcraft, Inc.'s sales into New York were as follows:

1990	1991	1992	1993	1994	1995
$4,811,030	$4,979,232	$5,652,464	$6,487,784	$7,102,428	$18,076,630[16]

25. By a letter dated October 5, 2000, the Division advised petitioner that its field audit "has resulted in an increase to your tax liability in the amount of $1,349,640.00" in total for the six fiscal years at issue herein plus the 1989 fiscal year. By its letter dated October 23, 2000 in response, petitioner noted that it disagreed with the Division's "conclusions with respect to including nontaxpayers' factors in the numerators of the components of the business allocation percentage," and that "total tax and interest attributable to other issues will result in a refund." In response, the Division issued a Notice of Deficiency dated November 30, 2000 asserting total tax due for the six fiscal years at issue of $1,7344,614.00 plus interest, with "payments/credits" of $824,815 for a balance due of $1,359,659.42.

26. The Disney subsidiary, Walt Disney Pictures & Television, Inc., owned all of the original negatives of films constituting the Disney film library. As of September 30, 1989 at the start of the audit period, there were a total of 251 original negatives comprising the Disney film library, and as of

[15] Karen Mbanefo, petitioner's senior tax manager and primary factual witness, did not know if the two subsidiaries shared other management officers.

[16] Ms. Mbanefo testified that this dramatic increase in sales into New York resulted from the introduction of sales on-line.

September 30, 1995 at the end of the audit period, there was an increase to a total of 388 original negatives comprising the Disney film library. These original negatives were used only when necessary to make "masters," which were then used to make copies for distribution to movie theaters and to make video cassettes and DVD copies. Masters are used for duplication purposes so that the original negatives, which are extremely fragile, would remain secure in highly protected storage at a location operated by Pro-Tek, a subsidiary of Eastman Kodak, located near Burbank, California. The original negatives are extremely valuable because the quality of a print decreases with each step that is taken away from the original negative. Petitioner's valuation expert, Alfred King, utilizing an "income approach" established the following values for the film library during the audit period:

Valuation Date	Value
Sept. 30, 1989	$1.775 billion
Sept. 30, 1990	2.252 billion
Sept. 30, 1991	2.505 billion
Sept. 30, 1992	3.378 billion
Sept. 30, 1993	4.628 billion
Sept. 30, 1994	5.959 billion
Sept. 30, 1995	7.302 billion

27. As noted in the above findings of fact, petitioner received substantial royalty revenues[17] from its licensing to third parties of its nearly 1,000 characters at the start of the audit period and

[17] Petitioner's royalty net income represented 26 percent, 37 percent, 50 percent, 69 percent, 100 percent and 70 percent of petitioner's business net income for fiscal years 1990, 1991, 1992, 1993, 1994 (when it had a net loss from its other operations), and 1995.

approximately 1,200 characters at the end of the audit period. The characters were essentially likenesses or representations of people or animals or objects that have appeared in Disney films over the years and included, for example, the following seven princes and princesses: (i) Prince of Snow White and the Seven Dwarfs; (ii) Prince Charming of Cinderella; (iii) Prince Eric of Little Mermaid; (iv) Prince John of Robin Hood; (v) Prince Phillip of Sleeping Beauty; (vi) Princess (cow) of One Hundred and One Dalmatians; and (vii) Princess Aurora of Sleeping Beauty. Again utilizing an "income approach" methodology as he did in valuing Disney's film library, petitioner's valuation expert, Alfred King, established the following values for the Disney characters during the audit period:

Valuation Date	Value
Sept. 30, 1989	$2.852 billion
Sept. 30, 1990	2.774 billion
Sept. 30, 1991	2.873 billion
Sept. 30, 1992	5.113 billion
Sept. 30, 1993	7.396 billion
Sept. 30, 1994	6.376 billion
Sept. 30, 1995	6.802 billion

The above values did not take into consideration that the characters are used internally by various members of the Disney Group. For example, they are used in theme park operations. Consequently, according to petitioner's expert, the above values would have been greater if affiliated-company usage had been valued and taken into consideration.

28. The parties entered into a stipulation of facts dated February 13, 2003 by petitioner and undated by the Division (marked into the record as Petitioner's Exhibit "34"), relevant portions of which have been incorporated herein.[18]

Procedural Permutation

29. As noted in Finding of Fact "25", the Division issued a deficiency notice against petitioner. With its original petition dated February 26, 2001, petitioner contested this notice, and in addition, it claimed that in calculating its business allocation percentages to New York, the property factor should have included a value for certain intangible assets, i.e. the characters detailed in Finding of Fact "27", that generated royalty income from the licensing of their use. It sought to have the third-party licensing income removed from its combined entire net income since the characters were not so valued and included in the property factor.

30. Subsequently, petitioner sought leave to file an amended petition by a motion dated December 3, 2002, which was granted. The amended petition expanded upon and fine-tuned the relief sought with regard to petitioner's contention that New York's formula for determining its business allocation percentages had the effect of taxing royalty income without considering the intangible assets generating such income. Petitioner asserted that if it was determined that its third-party royalty income should not be removed from its combined entire net income, that either its property factor should include

[18] This stipulation set forth the various subsidiaries included in the Disney combined reports filed with New York, additional subsidiaries which "As determined in the audit, should also have been included in the combined report[s]," and subsidiaries which the parties agree were "subject to the imposition of the Article 9-A tax." As emphasized by petitioner in its brief, " Petitioner and the Division now agree that all of Petitioner's subsidiaries that were included in the Disney federal consolidated return (other than inactive corporations and those that were or would be subject to tax in New York under articles of the Tax Law other than Article 9-A) should be included in a combined report with Petitioner ("the Disney Group") for purposes of the Article 9-A Tax for all years during the Audit Period" (Petitioner's brief, pp. 5-6).

a value for the characters, or that a fourth factor be added that would represent the value of the characters. In addition, the amended petition also requested that, if the third-party royalty income should not be removed from its combined entire net income, then the sourcing of the third-party royalty receipts for purposes of petitioner's receipts factor be changed, from the methodology originally used of the business location of the licensee noted in the licensing agreement to the location where the licensee's products were manufactured. In addition, the amended petition also requested that the method used on its combined tax reports for computing the value of its film masters be changed to a fair market value rather than the lesser value equal to their original cost which had been used.

SUMMARY OF THE PARTIES' POSITIONS

31. Petitioner complains that the Division "is effectively treating the Disney Group as one corporation rather than respecting the separate existence of each corporation" by including receipts from sales made by those members of the Disney Group not subject to tax by New York State in the numerator of the receipts factor of the business allocation percentage for the Disney Group and by including the salary of New York-based salespeople and their cars used in New York of Buena Vista Home Video in the numerator of the payroll and property factors, respectively, of the business allocation percentage for the Disney Group even though this subsidiary is not subject to tax by New York State. Petitioner maintains that petitioner's New York combined group consists of taxpayers and nontaxpayers, and that, in the words of one of its experts, "It's not contradictory to combine income of a unitary group and to also use separate factors to determine where economic activity occurs for each member of the unitary group." According to petitioner, Public Law 86-272 protects the nontaxpayers

from taxation by New York, and in its expert's words, even if it "may be stupid from an economic[19] perspective . . . it is the law" (tr., 850). New York's "apportionment scheme," according to petitioner, cannot "trump, so to speak, a federal law" (tr., p. 915). As a result, petitioner maintains that New York lacks jurisdiction to impose tax on income earned by the nontaxpayer subsidiaries included in its combined reports because "only certain members of the Disney Group were, as separate legal corporations, actually subject to New York tax" (Petitioner's brief, p. 8). Petitioner argues that the protection of Public Law 86-272 was not forfeited "merely because the Nontaxpapers file as part of the Disney Group" (Petitioner's brief, p. 61). Further, petitioner asserts that the Commerce and Due Process Clauses of the United States Constitution require that for purposes of computing its New York entire net income, royalty income and expenses related thereto should be excluded because the intangible property located in California generating such income has not been included in the apportionment formula. In the alternative, the value of its characters, the intangible property at issue, should be included in the formula at the fair market value established by its expert at the hearing. If royalty income is included in its tax base, petitioner contends that such income should be assigned to the venue where the licensed goods were manufactured. Finally, petitioner maintains that its film negatives should be included in the property factor at the fair market value established by its expert at the hearing rather than their cost value which it had used in its reports.

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[19] In its brief, petitioner "admits that Professor Shapiro's argument [that inclusion of the New York-source factors of the nontaxpayers in the numerators of the Disney Group's apportionment factors is necessary to cure distortion] is correct if one views the situation purely from an economic viewpoint, in the absence of Public Law 86-272 and in the absence of the basic tax principle that the separate status of each corporation must be respected" (Petitioner's brief, p. 71). It is inexplicable why petitioner earlier in its brief contended that "Inclusion of the New York-source factors of BVHV, Catalog, and Childcraft in the numerators of the Disney Group's apportionment factors is not necessary to cure distortion and only results in impermissible taxation of their protected income" (Petitioner's brief, p. 69).

32. The Division counters that nontaxpayer corporations may be included in a combined report if their noninclusion would have a distortive effect on a taxpayer's tax liability. The tax at issue, according to the Division, is not imposed on the subsidiaries which are nontaxpayers, but on the combined group or unitary business of which they are a part. The Division maintains, citing legislative history ignored by petitioner, that "*Public Law 86-272's limitation on a state's jurisdiction to tax the net income of a corporation does not impact a State's unitary apportionment scheme*" (Division's brief, p. 117 [emphasis in original]). Further, the Division asserts that intangible assets do not qualify for representation in the property factor since such property does not constitute corporeal personal property. The Division contends that New York's application of its business allocation percentage to petitioner's unitary business income without including a specific property value for intangible assets is constitutional because petitioner has failed to establish that the result was "grossly distortive" (Division's brief, p. 53). The Division maintains that "combined reporting intrinsically accounts for the intangible values of the petitioner's Characters"[20] (Division's brief, p. 56), and that "*combined reporting is the best solution for representing the value of the petitioner's intangible assets in its business allocation percentage*" (Division's brief, p. 87 [emphasis in original]). In addition, according to the Division, a request for a discretionary adjustment must be attached to the tax return being filed. Petitioner never requested a discretionary adjustment during audit or as an attachment to its respective returns. The Division rejects petitioner's contention that its receipts from licensing should be changed to where the manufacturing plants are located because, "*The petitioner's copyrights are used to sell the*

[20] In a lengthy footnote "18" included in its brief, the Division emphasized that in the four U.S. Supreme Court cases that have addressed the apportionability of income from intangible assets, none involved combined reporting nor the royalty income from third-party licensing of intellectual property.

licensees' products not to aid in the manufacturing of the product" (Division's brief, p. 100 [emphasis in original]). Finally, the Division rejects the inclusion of petitioner's film negatives in the property factor at the valuation developed by petitioner's expert because, "*The study valued more than tangible personal property; it valued the petitioner's intangible right to copy its movies*" (Division's brief, p. 106 [emphasis in original]).

CONCLUSIONS OF LAW

A. During the years at issue, Disney Enterprises, Inc., the parent corporation then known as The Walt Disney Company, was subject to New York's corporation franchise tax as a New York taxpayer to be computed upon the portion of its entire net income allocable to New York. Further, this parent corporation, as noted in footnote "18", was required to file New York combined reports with *all of its subsidiaries* "that were included in the Disney federal consolidated return." As noted in the findings of fact, it was only as a result of significant give and take between the parties, in the course of the Division's prior audit of earlier years as well as during the Division's review of petitioner's own request dated October 29, 1993 for permission to file a combine report, as detailed in Finding of Fact "13", that the parties' positions evolved to one in which they both agreed that Disney Enterprises, Inc. was required to file New York combined reports with all of its active[21] subsidiaries (except for certain unspecified subsidiaries that were or would be subject to tax in New York under articles of the Tax Law other than Article 9-A, at issue herein).

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[21] As detailed in Finding of Fact "14", the changing lineup of subsidiaries included in the New York combined report for each of the respective years presumably relates to a particular subsidiary's status as an active or inactive enterprise. If inactive, it was no longer necessary to include it in the combined report.

B. In spite of the above agreement, petitioner nonetheless maintains that three of the subsidiary corporations properly included in its New York combined group for each of the six years at issue were *non-New York taxpayers*, with no individual nexus with New York, whose New York destination sales, therefore, may not be treated as New York receipts for purposes of calculating petitioner's business allocation percentage. According to petitioner, Federal law and the United States Constitution impose such prohibition on New York's authority to tax. In effect, petitioner would limit the effect of petitioner's agreement that all active Disney subsidiaries were properly included in its New York combined group for each of the years at issue so that the economic activities in New York of these three subsidiary corporations may not be fully considered when computing petitioner's entire net income for New York corporation franchise tax purposes based upon New York's apportionment formula. To sustain petitioner's proposition would undermine the purpose of New York's combined reporting law by requiring a blind eye to the intercorporate relationship between these three subsidiary corporations and the parent corporation as well as other members of petitioner's New York combined group which did have individual nexus with New York and were undeniably New York taxpayers. As discussed below, if there is an interdependence between entities that mandates that they all be included in a New York combined report, it is of no matter that some might have no nexus individually given their intimate ties to parent and sister entities, which are New York taxpayers with individual nexus with New York. The very status of being part of the combined group provides the justification for the imposition of New York corporation franchise tax on the fruits of their economic activity in New York, as measured by New York's reasonable apportionment formula as prescribed by statute and regulation.

C. Tax Law § 211(4) provides, in relevant part, as follows:

> In the discretion of the commissioner, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations . . . may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the commissioner may require; . . . provided, further, that no combined report covering any corporation *not a taxpayer* shall be required unless the commissioner deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article . . . . (Emphasis added.)

D. With its decision in ***Matter of Standard Manufacturing Co.*** (Tax Appeals Tribunal, February 6, 1992), the Tribunal established that the Commissioner's discretion to require or permit the inclusion of nontaxpayers, like Buena Vista Home Video, Childcraft, Inc., and The Walt Disney Catalog, in a combined report with a parent corporation which is a taxpayer,[22] like Disney Enterprises, Inc., "must be based on the rationale that such combination is necessary to properly reflect franchise tax liability." Consequently, the question of income distortion is applicable where the combined report involves inclusion of nontaxpayers in a New York combined report. The distortion of income test, as delineated in the Division's regulations at 20 NYCRR 6-2.3(a), provides, in part, that the Division:

> may permit or require a group of taxpayers to file a combined report if reporting on a separate basis distorts the activities, business, income or capital in New York State of the taxpayers. The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations.

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[22] Disney Enterprises, Inc. is a "taxpayer" as the term is used in Tax Law Article 9-A at section 208(2) even though it is a foreign corporation since the statute's definition of "taxpayer" is "any corporation subject to tax under Article 9-A." In New York, pursuant to Tax Law § 209(1) every corporation that avails itself of "the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in [New York] in a corporate or organized capacity or of maintaining an office in [New York]" must pay a tax imposed by Article 9-A.

The findings of fact clearly establish that the unique and extraordinary synergies among the Disney entities as well as the flow of services among them, without arm's length pricing for such services, support the conclusion that the income of the various members of the Disney combined group would be distorted unless combined reports are utilized.

E. The Federal statute, Public Law 86-272 (15 USC §§ 381-384), which immunizes a corporation from state income taxation if certain conditions are met, provides in relevant part as follows:

> No State . . . shall have power to impose, for any taxable year . . . . a net income tax on the income derived within such State by any person from interstate commerce if the *only* business activities within such State by *or on behalf of* such person during such taxable year are . . . the solicitation of orders by such persons, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved, are filled by shipment or delivery from a point outside the State . . . (15 USC § 381 [emphasis added]).

Congress enacted this constraint on state taxation pursuant to its authority under the commerce clause to regulate interstate commerce. A plain reading of this 1959 law establishes its inapplicability to the facts at hand. It simply cannot be concluded that the *only* business activities within New York by Buena Vista Home Video, Childcraft, Inc. and The Walt Disney Catalog by *or on behalf of* these entities was the solicitation of orders for sales of tangible personal property. The Disney stores in New York, operated by a sister entity, promoted the very products also sold by The Walt Disney Group and Buena Vista Home Video, and in contradiction of petitioner's position, Childcraft, Inc. also sold Disney branded products through at least one of its catalogs. In addition, as noted in Footnote "5", management of Childcraft, Inc. ran the Disney catalog, and merchandise marketed through the three types of catalogs overlapped. Furthermore, as detailed in the findings of fact, as members of petitioner's combined group, these entities benefitted from activities performed in New York on their

behalf by other members of the combined group in light of the extraordinary synergies of the overall Disney operation as detailed in Finding of Fact "9." A review of the legislative history of 86-272 shows that this limitation on state power was never intended to extend to the taxation of corporations which are part of an enterprise like petitioner's, which has conceded that there are substantial intercorporate transactions among the three nontaxpayer subsidiaries and the rest of the Disney empire (***see***, ***Gillette Co. v. Tax Comm.***, 56 AD2d 475, 393 NYS2d 186, ***affd*** 45 NY2d 846, 410 NYS2d 65 [wherein the legislative history of Public Law 86-272 is discussed in detail]). These substantial intercorporate transactions prompted the parties' agreement on the filing of combined reports for the years at issue, which included Buena Vista Home Video, Childcraft, Inc., and The Walt Disney Catalog. Combined reports would not have been required but for the benefits flowing to these three subsidiaries from the business activities of other Disney entities in New York, which consisted of much more than the mere solicitation of orders.

Further, protections afforded by the Commerce Clause of the United States Constitution are not violated by including the New York receipts of these three subsidiaries in New York's formula for apportioning the entire net income of a combined group to the State. The Supreme Court has noted that, "As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation" (***Shell Oil Co. v. Iowa Dept. of Revenue***, 488 US 19, 30-31, 102 L Ed 2d 186). In addition, although determinations of administrative law judges have no precedential value pursuant to Tax Law § 2010(5), a review of the United States Supreme Court decisions referenced by the administrative law judge in ***Matter of Alpharma*** (Division of Tax Appeals, September 12,

2002), in her quotation from an article by petitioner's representative, supports her rejection of the same contention raised by petitioner in this matter concerning limitations on New York's ability to tax under Public Law 86-272 and the United States Constitution:

> A review of the United States Supreme Court decisions [that relate to this issue–], from ***Complete Auto Transit, Inc. v. Brady*** (430 US 274) through ***Mobil Oil Corp. v. Commissioner of Taxation of Vermont*** (445 US 425), ***Exxon Corp. v. Wisconsin Dept. of Revenue*** (447 US 207) and ***Container Corp. of America v. Franchise Tax Bd*** (463 US 159) results in the conclusion that a state may constitutionally tax the activities of a corporation only when those activities themselves have sufficient nexus (connection) with the state or *when those activities are part of a unitary business that has sufficient nexus with the state* (Rosen, *New York State Corporation Franchise Tax*, Practising Law Institute [323 PLI/Tax 27 1991]) (emphasis added).

F. In light of the above analysis, it is not necessary to resolve the Division's complaint that petitioner failed to establish the nontaxpayer status of Buena Home Video, Childcraft, Inc. and The Walt Disney Catalog, on the basis that none of these three subsidiaries had individual nexus with New York.[23] Nonetheless, the Division is correct that the testimony of Karen Mbanefo, a senior tax manager in the corporate tax division of the parent corporation, Disney Enterprises, Inc., who currently manages state income tax audits for petitioner, was not based upon personal knowledge of the activities of the three subsidiaries. Her employment with petitioner commenced in 1998, well after the audit period. Although Ms. Mbanefo was an articulate and highly professional individual, she admitted that her knowledge of the activities of the three subsidiaries was based upon her review of petitioner's books and records as well as "discussions with corporate personnel or employees to understand how

[23] The Division at the time of its audit did not request any information concerning the nexus relationship of these three subsidiaries with New York, in the auditor's words, "because the companies were included in the combined group and they were filing a combined report" (tr., p. 625).

the operations work" and not her personal knowledge (tr., p. 28). This lack of personal knowledge was revealed as a serious shortcoming on skillful cross-examination when she was confronted with a business news article from the April 19, 1988 issue of the Orange County Register[24] entitled "Disney expands retail operations / / Buys direct-mail business, to open 10 stores in east" by a reporter named Juanita Darling. This article emphasized the interdependence of Disney's subsidiaries involved in the retailing of consumer products including Disney's retail stores, and directly contradicted a key fact set forth in an affidavit of one of the individuals who Ms. Mbanefo consulted in her preparation for the hearing. In his affidavit dated February 7, 2003, Steve Finney, the chief financial officer of Childcraft, Inc. and Walt Disney Catalog, Inc. stated:

> [Walt Disney Catalog, Inc.'s] catalog contained products that all evidenced a Disney-owned character likeness. [Childcraft, Inc.] sold children's clothing through its catalogs. *None of the products sold by Childcraft had a Disney-owned character likeness printed on it.* (Emphasis added.)

In direct contradiction, the news article quoted a Disney employee, Barton Boyd,[25] described as "president of Disney Consumer Products," as saying that "one Childcraft catalog, Just for Kids, already contains Disney products." Further, this news article also noted that Childcraft's large and high quality mailing lists, according to Mr. Boyd, would "help bolster expansion of Disney's direct mail publication,

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[24] Petitioner's Disneyland and its corporate headquarters are located in California's Orange County, and The Orange County Register is a well-known publication which petitioner itself quoted at length in its 1990 annual report.

[25] Petitioner offered into evidence an affidavit of Bo Boyd dated February 6, 2003, who Ms. Mbanafo indicated was the same individual as Barton Boyd quoted in the news article. However, Mr. Boyd's affidavit addressed the issue concerning petitioner's royalty income from licensing agreements and its "domestic merchandise licensing operations" and *oddly* not the operations of the three subsidiaries which petitioner claims were non-New York taxpayers with no individual nexus with New York although it would appear he had substantial knowledge of such operations as president of petitioner's consumer products division during the audit period.

the Walt Disney Family Gift Catalog." As noted in Footnote "5", petitioner's form 10-K reports indicate there is an overlapping at times of the merchandise marketed through catalogs of Childcraft, Inc. and The Walt Disney Catalog. Most important, the catalogs and Disney retail stores located in New York, as detailed in Finding of Fact "23", shared promotions and sold similar items, and it is also likely that items purchased from the catalogs could be returned at the stores in New York.[26] It must be noted that petitioner's failure to provide relevant evidence of the operations of these three subsidiaries from a witness with personal knowledge of their operations, namely Barton Boyd, who was president of petitioner's consumer products division *during the audit period*, must be held against it especially in light of its introduction of Mr. Boyd's affidavit dated February 6, 2003 into evidence on a tangential subject (***see, Matter of Meixsell v. Commissioner of Taxation***, 240 AD2d 860, 659 NYS2d 325, ***lv denied*** 91 NY2d 811, 671 NYS2d 714).

Nonetheless, whether these three subsidiaries were nontaxpayers without individual nexus with New York is not determinative of the issue designated as "I", as noted in Conclusion of Law "E". Rather, it is their inextricable relationship to petitioner's unitary business that results in the rejection of petitioner's contention that their New York receipts should be excluded from the numerator of the receipts factor, and in the case of Buena Home Video that its New York payroll and property should be excluded from the payroll and property factors. The synergistic relationship of the three

[26] Petitioner's factual witness was unable to answer this question concerning the ability to return items purchased through a catalog at the retail store as noted in Finding of Fact "23." In light of the fact that petitioner had the ability to resolve this factual issue by the introduction of evidence, in particular, the testimony of Mr. Boyd as noted in this Conclusion of Law, it is reasonable to presume that items purchased from a catalog could be returned at a retail store in New York since if the opposite was the case, petitioner would have certainly brought out that fact.

subsidiaries with each other and with other members of the New York combined Disney group involved in the retailing of consumer products is the relevant focus for the resolution of this initial issue. Petitioner's attempt to isolate the operations of each of the three subsidiaries from the overall Disney organization as well as each other is rejected since they were all part of Disney's consumer products division and coordinated retail distribution. Petitioner's argument that Childcraft, Inc. and The Walt Disney Catalog were not a business unit of their own and not run together as a separate division is rejected as a technical formality and splitting of hairs which ignores the substance of their shared and coordinated operations. Further, the record establishes and petitioner has conceded by its agreement to file combined reports that it was not possible to determine the net income attributable to each member of petitioner's unitary business by means of separate accounting in light of their inextricably related operations.

G. In computing the tax asserted due of $1,359,659.42 in the Notice of Deficiency, as detailed in Finding of Fact "25", the Division apportioned petitioner's combined entire net income to New York by multiplying petitioner's combined business income by its business allocation percentage ("BAP"), which in New York is based upon three factors: property, receipts, and payroll. Tax Law § 210(3)(a) provides for calculating these factors as follows:

> (1) ascertaining the percentage which the average value of the taxpayer's real and tangible personal property, whether owned or rented to it, within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property, whether owned or rented to it, wherever situated during such period . . . ;
>
> (2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

> (A) sales of its tangible personal property where shipments are made to points within this state,
>
> (B) services performed within the state . . . ,
>
> (C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, . . . and
>
> (D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals royalties, . . . whether within or without the state;
>
> (3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers.

H. New York is one of many states which use these three factors of property, payroll, and receipts in their apportionment formulas because these factors "reflect a very large share of the activities by which value is generated" (***Container Corp. of America v. Franchise Tax Bd.***, 463 US 159, 77 L Ed 2d 545). The property factor reflects the location of the capital used to generate the income, the payroll factor reflects the location of labor used to generate the income, and the receipts factor reflects the location of the corporation's customers. New York, a so-called "market state" with its large population of consumers, has decided to double-weigh the receipts factor so that in determining a taxpayer's BAP, the percentage of New York receipts is added in twice along with the percentage of New York property, and of New York payroll, with the total then divided by four to determine the BAP (Tax Law § 210[3][a][4]). Further, New York, with its many corporate headquarters and its desire to remain attractive as the situs for corporate headquarters, excludes from its apportionment

formula, as noted above, the salaries of "general executive officers." States have shown they have considerable discretion and leeway in legislating their own unique BAP. Dr. Robert Cline, petitioner's expert witness on apportionment issues, noted that, in his evaluation of the apportionment formulas in approximately 35 states for tax policy purposes, the basic question posed is who pays taxes and how do the liabilities change when you alter apportionment factors. Dr. Cline candidly testified that in the State of Iowa, two major manufacturers, Maytag and John Deere, exerted influence at the time the corporate income tax was adopted in that State so that property and payroll were *not* included in the apportionment formula. Iowa, which is not a market state with a large consumer population, nonetheless, and surprisingly, uses a single sales factor.[27] Consequently, states, including New York, have significant flexibility in devising their apportionment formulas and as demonstrated in the Iowa example, the legislative process may be influenced by many factors. Dr. Cline noted that the Federal government has not stepped in to demand a uniform approach to apportioning income of multi-state corporations. Nonetheless, petitioner challenges New York's failure to include the value of *intangible* property in its formula and contends that the Commissioner has abused his discretion by not adjusting the formula in the situation at hand where petitioner's economic activities in New York result, in large measure, from the use of its valuable intangible property which it contends has not been factored into the apportionment formula.

I. As noted above, the property factor was specifically defined by statute to include the real property and the tangible personal property of the taxpayer. Tangible personal property is, in turn,

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[27] Prof. Richard Pomp, petitioner's other expert, noted that Maytag and John Deere "essentially sold outside Iowa and ended up paying no Iowa tax" (tr., p. 448).

defined to mean “corporeal personal property” and excludes intangible assets like “money, deposits in banks, shares of stocks, bonds, notes, credits, or evidences of any interest in property and evidences of debt” (Tax Law § 208[11]). The value of petitioner’s characters, as intangible property, albeit unique and extremely valuable, in the first instance was properly excluded from inclusion in petitioner’s property factor for purposes of computing its BAP given this statutory definition. Petitioner’s expert, Dr. Robert Cline, testified that petitioner is “closer to the financial institution end of the spectrum than it is the typical manufacturer end of the spectrum” (tr., p. 364). Nonetheless, although the taxation of banks in New York under Article 32 takes into consideration the value of intangibles and their situs, the same does not hold true under Article
9-A which is applicable to this matter.[28] Furthermore, the intangibles at issue here are not that similar to financial intangible assets. For example, petitioner’s own expert, Dr. Cline, testified that the intangible “goodwill” is *diffused* through a business.[29] He attempted to distinguish the Disney characters from goodwill by describing them as “visible intangibles,” not “invisible intangibles.” Nonetheless, it cannot be denied that the value of the Disney character rises as the sales of items of tangible personal property with Disney characters as well as the success of Disney films and theatrical productions increase. It is

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[28] Petitioner’s expert, Prof. Richard Pomp, admitted that he did not know of any states that include the value of intangible assets within its property factor for general business corporations, although he hedged his response with the comment, “I have not done a study” (tr., p. 449). Nonetheless, it is reasonable to conclude that there is no state that does so. Given petitioner’s extraordinary presentation, which reflects enormous time and effort, if there were one, it would have certainly been uncovered to bolster its case.

[29] Petitioner’s other expert, Prof. Pomp, noted the difficulty of siting this intangible asset:

> And I wouldn’t begin to know where to source that. I mean where do you put goodwill? In a way, it could be viewed as being part of your property and part of your payroll and part of your receipts. And if you think of it as being apportioned in the same ratio you already are apportioning your payroll, property and receipts, it really doesn’t matter whether you include it or not. (Tr., p. 442.)

simply not unreasonable to view the Disney characters as similarly *diffused* throughout petitioner's unitary business. If the *Lion King* is a standing room only hit on Broadway, the Disney Lion King characters increase in value throughout the unitary business. Lion King branded sheets and curtains sell more readily in Peoria, and Lion King displays in the Disney theme parks become more popular. Similarly, what helps to give Cinderella her monetary value is that a million New York girls and boys fell in love with her at the movies in New York or while watching her on their VCRs in their New York living rooms, and Mickey Mouse's value comes from his use[30] over the years throughout the world in developing his timeless appeal including his use in New York through the sale of Mickey Mouse movies, products, etc., not that Cinderella and Mickey Mouse are managed and controlled out of Southern California. Furthermore, Prof. Richard Pomp, one of petitioner's experts, when asked whether the situs of an intangible asset may be "where the asset is exploited," responded with "define what you mean by exploited" (tr., pp. 449-450). This careful response demonstrates the difficulty of siting intangibles. In sum, petitioner has not sustained its burden to establish its Disney characters are properly sited in California *only* and that their nearly seven billion dollar value, as estimated by its expert, should also be sited in California *only* for purposes of New York's apportionment formula.[31]

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[30] Petitioner's third expert, Albert King, noted that

> The more they [Disney] expose the characters in third party licensing, the better they do with the general recognition by the general public of the Disney character, hence increasing revenues at the theme parks, increasing revenues from rereleases of the older movies where most of the characters come from. (Tr., p. 544.)

[31] Petitioner's expert, Dr. Robert Cline, testified that he did not know if petitioner included the intangible assets as a factor in its apportionment formula for California. Petitioner introduced no evidence on this point. It is safe to conclude, however, that it did not include the intangible assets as a factor in its California apportionment formula since it would have resulted in a substantially increased California state tax liability, and if it had, it certainly would have brought out that fact in this proceeding.

The mere fact that the characters might be managed and controlled in Southern California does not justify siting their value only in Southern California when their extraordinary value is a result of success and sales in the marketplace, which would support their siting where their success and sales occur. In the persuasive words of Dr. Alan Shapiro, "value that a company creates is based on the products and services that it produces and sells in the marketplace" (tr., p. 717). It is this commercial success which produces the "intangible assets that have substantial value" (tr., p. 729).

J. Petitioner also contends that New York's statutory formula, which does not include the value of intangibles in the property factor, as applied to it results in a violation of its rights under the Commerce and Due Process clauses of the United States Constitution. However, petitioner has failed to establish that there is a sufficient mismatch of the apportionment formula and the income that it is used to apportion, including royalty income from the licensing of the Disney characters, so that the fair apportionment requirement of the Commerce Clause and any of its rights under the Due Process clause, have been violated. As noted in Finding of Fact "16", petitioner allocated its business income to New York during the six years at issue based upon business allocation percentages ranging from a low of 1.6292% in 1993 to a high of 2.7649% in 1992. Given the size of New York's market (e.g., as noted in Finding of Fact "6", 10.5% of the Disney Catalog's sales in 1992 were to New York), the business allocation percentages are, on their face, within a reasonable range. This is especially so given recognition by the United States Supreme Court of "[t]he difficulty of making an exact apportionment" and that "when the State has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases" (***Hans Rees' Sons, Inc. v. North Carolina***, 283 US 123, 133, 75 L Ed 879). In this Supreme Court case, the court determined

that "the [North Carolina] statutory method, as applied to the appellant's business . . . operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State" (***Hans Rees' Sons, Inc. v. North Carolina***, 283 US 123, 135). The taxpayer manufactured leather in its one and only manufacturing plant in North Carolina. However, nearly *all* of its sales were outside of North Carolina. Nonetheless, North Carolina allocated in two of the four years at issue 85+ percent of the income to North Carolina, 83+ percent and 66+ percent in each of the other two years while the court quoting the lower court noted that the evidence in the record "tends to show that for the [years at issue], the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent."

In a more recent Supreme Court case, the court sustained the application of an apportionment formula that resulted in taxable income of $4,532,555.00 for the taxpayer, while the taxpayer's returns, based on separate state accounting methods reflecting only the State operation, showed losses for each of the years at issue (***Exxon Corp. v. Wisconsin Dept. of Revenue***, 447 US 207, 65 L Ed 2d 66). Similarly, an examination of the underlying facts in ***Alpha Portland Cement Co. v. Knapp***, (230 NY 48), the 1920 Court of Appeals case relied on by petitioner, shows a similar gross mismatch of the apportionment formula and the income that it is used to apportion where 100% of the interest income on bonds in a Pennsylvania corporation that owns manufacturing plants in Pennsylvania held by the taxpayer in an out-of-state home office were included in the taxpayer's net income subject to New York's tax without factoring such bonds into the apportionment formula. In the matter at hand, petitioner has not similarly demonstrated "by clear and cogent evidence that the income attributed to

New York was in fact out of all appropriate proportion to the business petitioner transacted in New York or has led to a grossly distorted result," and therefore it has not established that any of its rights under the Commerce Clause or Due Process Clause of the United States Constitution have been violated (***Zelinsky v. Tax Appeals Tribunal***, 1 NY3d 85, ___ NYS2d ___).

K. Furthermore, the Division has raised sufficient concerns about the testimony and reports of petitioner's experts by its own expert's testimony and report to defeat petitioner's attempt to meet its heavy burden to establish that the statutory formula at issue attributed a percentage of its income to New York out of all appropriate proportion to the business activities of petitioner's unitary business in New York (***cf., Matter of Sherwin Williams***, Tax Appeals Tribunal, June 5, 2003 [wherein the Tribunal relying upon the expert report of Dr. Alan Shapiro noted that an intangible asset "standing alone, has no intrinsic value" and the taxpayer's experts had thereby overvalued certain intangible assets held by a Delaware subsidiary with no nexus to New York]). Petitioner's own expert, Dr. Robert Cline, testified in this matter that "states have the right to adjust [their statutory] formula in any way consistent with their overall objectives" (tr., p. 367). Dr. Cline gave this opinion in the context of his discussion of the evolution of state statutory formulas during which he noted that:

> [I]n the original apportionment formula many economists said that only payroll and property should be included. The market states disagreed. (Tr., p. 366.)

New York, as a market state, includes sales in the formula and, in fact, double weights sales, as noted in Conclusion of Law "H".

L. Similarly, the Commissioner did not abuse his discretion in refusing to make the requested adjustments under Tax Law § 210(8) which provides as follows:

> If it shall appear to the [Commissioner] that any business or investment allocation percentage or alternative business allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the state, the [Commissioner] shall be authorized in [his] discretion, in the case of a business allocation percentage . . . , to adjust it by (a) excluding one or more of the factors therein, (b) including one or more other factors, such as expenses, purchases, contract values (minus subcontract values), (c) excluding one or more assets in computing such allocation percentage, provided the income therefrom is also excluded in determining entire net income or minimum taxable income, or (d) any other similar or different method calculated to effect a fair and proper allocation of the income and capital reasonably attributable to the state . . . .

To *compel* the Commissioner to exercise his discretion under this provision requires much more than the taxpayer's ability to establish that its proposed methodology and formulas for apportioning its income to New York may be a more accurate or exact way to reflect its business activity in this state. Rather, in order to *compel* the Commissioner to act under this provision, petitioner is required to make the same showing as discussed above when it was concluded that its rights and protections under the Due Process and Commerce clauses of the Constitution had not been violated (***see, British Land v. Tax Appeals Tribunal***, 85 NY2d 139, 623 NYS2d 772). A review of the decision of Tax Appeals Tribunal in ***Matter of British Land (Maryland), Inc.*** (September 3, 1992), which was reversed by the Court of Appeals, shows that an adjustment under section 210(8) of the Tax Law was also at issue on the administrative level although the court based its own decision upon the Due Process and Commerce clauses of the United States Constitution. However, after noting that the Tribunal's determination "must be annulled," it remanded to the Tribunal "for a redetermination of an allocation of petitioner's income more fairly reflecting its business activities in this State" under the statutory provision at issue, i.e., Tax Law § 210(8) (***British Land v. Tax Appeals Tribunal***, ***supra*** at 150). In sum, since petitioner has not established that the statutory method it attacks attributed to New York a

percentage of income out of all appropriate proportion to its business transacted in New York, the Commissioner may not be directed to use his discretionary power under Tax Law § 210(8).

Furthermore, as noted in Findings of Fact "29" and "30", it was not until the petition stage that petitioner for the first time raised the complex issue designated "II" at the start of this determination. To do so at the start of an adversarial proceeding is not timely when a party is seeking to appeal to the Commissioner's discretion. Moreover, a review of the findings of fact clearly shows the enormous complexity of petitioner's tax filings. Even determining the changing cast of entities to be included in the respective tax reports for the years at issue requires much effort. It was at the time when petitioner was determining how to file its original reports or even perhaps at the later audit stage when petitioner should have begun its appeal to the Commissioner's discretion, when it would have allowed for the necessary give and take between the parties in light of the complexity of petitioner's tax filings. Consequently, the Commissioner's regulation which requires that "A request to vary the statutory formulas must be attached to the report setting forth full information on which the request is based, together with a computation of the amount of tax which would be due under the proposed method" is reasonable, and this time limitation should be enforced in this matter (20 NYCRR 4-6.1[c]).

M. In light of the above resolution of Issue II against petitioner, it is necessary to address the issue designated Issue III at the start of this determination. Petitioner has failed to establish a basis for changing its original computation of royalty income from its licensing activities allocable to New York. Its original method of computing the numerator of its receipts factor based upon the New York business location of its licensees is a reasonable methodology. Its proposed methodology to recalculate the numerator of its receipts factor based upon the New York location of manufacturers contracted by

its licensees for the production of the licensed goods is rejected. First, it is observed that petitioner's own expert, Dr. Robert Cline, lent support to the original methodology accepted by the Division when he testified that petitioner's receipts from its licensing activities should be treated:

> [J]ust like the sale of tangible personal property. If a licensee pays the licensor to use a character it's the location. . . . And I would attribute it to where the licensee is located (tr., p. 346).

Further, a review of petitioner's licensing arrangements, as noted in Finding of Fact "3", where a sample license agreement is closely examined, shows that petitioner's licensing fees are calculated based upon a percentage of the licensee's net invoiced billings *on sales*, and is not related to the amount of goods *manufactured*. In the example examined, petitioner was to be paid nine percent of the licensee's net invoiced billings *on sales* of articles ranging from blankets and sheets to curtains and baby booties with Bambi characters up to $10,000,000.00. *On sales* of such Bambi products exceeding $10,000,000.00, petitioner was to be paid nine and one-half percent of net invoiced billings. *On sales* of Bambi products outside the specified territory up to $10,000,000.00, petitioner was to be paid 13 per cent of net invoiced billings, and finally *on sales* of these products exceeding $10,000,000.00 outside the specified territory, petitioner was to be paid 13 and one-half percent. Petitioner did not contract with its licensee to receive, for example, 15 cents for every pair of Bambi booties or 23 cents for every Bambi blanket manufactured in Guangzhou, China. Consequently, if it was at all administratively practical, the location of the licensee's *sale*s of goods would be a far better way to allocate petitioner's royalty income, which would be more reflective of the geographic location of the economic activities, i.e., the sales, from which petitioner directly benefits. Since New York is a market state, offering petitioner's licensees a large consumer market for their licensed goods, it is fair

to conclude that, in fact, a larger allocation of petitioner's royalty income based on the final sales of the licensed goods would better reflect the source of petitioner's royalty income which is based on such sales. Consequently, the original methodology used by petitioner, based upon the geographic location of its licensees, is more than fair to petitioner. In sum, petitioner has simply failed to establish how the decision of its licensees to shift the manufacture of goods to low-wage areas of the globe such as China, or other locations outside the traditional manufacturing areas of the United States, including New York, is relevant for the purpose of determining the portion of its royalty income to be allocated to New York since such income is based on the *sales* of such goods.

N. Finally, the issue designated "IV" at the start of this determination is also resolved against petitioner for reasons very similar to the analysis detailed in these Conclusions of Law concerning whether a value for intangible assets must be included in New York's apportionment formula. Most of the value prescribed by petitioner's expert for the film masters represents the value of the right to reproduce the films for sale in the consumer market. This copyright, which justifies the extraordinary value for the films, represents an intangible asset. Since there is no legal requirement that intangibles should be factored into New York's formula as discussed above, petitioner's contention that it should be permitted to include in the property factor its expert's value for the film masters is also rejected.

O. The petition of Disney Enterprises, Inc. & Combined Subsidiaries is denied, the Notice of Deficiency dated November 30, 2000 is sustained, and petitioner's claim for refund is denied.

DATED: Troy, New York
February 12, 2004

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE