STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
DISNEY ENTERPRISES, INC. & COMBINED SUBSIDIARIES	:	DECISION 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.[1]	:	

The Division of Taxation and petitioner Disney Enterprises, Inc.[2] & Combined Subsidiaries, 500 South Buena Vista Street, Burbank, California 91521, filed exceptions to the determination of the Administrative Law Judge issued on February 12, 2004. Petitioner appeared by McDermott, Will & Emery (Arthur R. Rosen, Esq. and Alysse B. Grossman, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Clifford Peterson, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in support of its exception and in opposition to petitioner's exception. Petitioner filed a brief in opposition to the Division of Taxation's exception and in reply to the Division of Taxation's

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[1]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.

[2] 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.

brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the request of both parties, was heard on April 14, 2005 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner McDermott took no part in the consideration of this decision.

ISSUES

I. Whether the Division of Taxation may include New York destination sales of Buena Vista Home Video of its combined group in the numerator of its combined receipts factor for its business allocation percentage when determining the taxable income of the taxpayer members of its combined group.

II. Whether petitioner is entitled to a refund based upon a change in the methodology it used to arrive at the fair market valuation for its film negatives for purposes of its combined property factor.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

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:

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:

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[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.

[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.

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

[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 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.

catalogs sell similar and, at times, the same products.[6] 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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[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 ("ADMINISTRATIVE LAW JUDGE"): Now, do you have any knowledge of the merchandise sold at Disney's retail stores?
> Ms. Mbanefo: Yes.
> ADMINISTRATIVE LAW JUDGE: [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?
> ADMINISTRATIVE LAW JUDGE: Let's first say similar products. Were there similar products?
> Ms. Mbanefo: Yes. There were similar products.
> ADMINISTRATIVE LAW JUDGE: 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,

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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.

each business unit in the Disney 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.
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> As stated previously, all entities in the consolidated federal affiliated group are directly or indirectly 100 percent owned subsidiaries.
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> 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.
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> *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., (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)

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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.

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. 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.

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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.

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 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., and (14) Wanderlust

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

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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.

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%

These business allocation percentages were computed by petitioner as follows:

	1990	1991	1992	1993	1994	1995
1. NewYork property	$ 35,550,536	$ 52,809,330	$ 64,382,261	$ 137,443,511	$ 203,466,343	$ 225,645,524

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

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 personal 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 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.

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[14] Petitioner agrees that Buena Vista 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.

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:

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

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 $1,734,614.00 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 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

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

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 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

[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.

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]

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[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).

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 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.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge began his analysis with a discussion of Public Law 86-272 and whether it is applicable to the facts set forth herein. The Administrative Law Judge noted that Disney Enterprises, Inc. was required to file New York combined reports with all of its active subsidiaries as outlined in the findings of fact above. Yet, the Administrative Law Judge stated that with respect to Catalog, Childcraft and Buena Vista Home Video (hereinafter "Video"), petitioner argued that these three subsidiaries were, in fact, non-New York taxpayers and, as such, were protected by Public Law 86-272.

After reviewing the language of the Federal statute, the Administrative Law Judge determined that it did not apply herein. In a literal reading of the statute, the Administrative Law Judge found that "[i]t simply cannot be concluded that the *only* business activities within New York by [Video, Childcraft and Catalog] by *or on behalf of* these entities was the solicitation of orders for sales of tangible personal property" (Determination, conclusion of law "E," emphasis supplied).

The Administrative Law Judge further reasoned that the Commerce Clause of the United States Constitution is not violated by including the New York receipts of these three subsidiaries in New York's formula for apportionment purposes. The Administrative Law Judge quoted the Supreme Court which has held that "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, 102 L Ed 2d 186, 199). Thus, the inclusion of the destination sales in the receipts factor by New York State did not result in any constitutional violations.

The Administrative Law Judge held that whether the three subsidiaries were nontaypayers without individual nexus with New York is not relevant for purposes of applying Public Law 86-272. The Administrative Law Judge reasoned that the three subsidiaries are inextricably linked to petitioner's unitary business and that prevents their various New York receipts from exclusion from the numerator. The Administrative Law Judge stated that by its agreement to file combined reports, petitioner has conceded that it was not able 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.

The second issue addressed by the Administrative Law Judge was whether New York's application of its business allocation percentage (hereinafter "BAP") to petitioner's unitary business income, which included royalty income, without including a specific property value of petitioner's intangible property in the property factor of the apportionment formula, violates the Commerce and Due Process Clauses or whether the Commissioner abused his discretion in refusing to make an adjustment under Tax Law § 210(8) to the apportionment formula to include petitioner's intangible property in the property factor.

The Administrative Law Judge noted that the Division apportioned petitioner's combined entire net income to New York by multiplying petitioner's combined business income by its BAP. After reviewing the applicable statute, and outlining the three factors utilized by New York State in its apportionment formula, the Administrative Law Judge stated that the property factor was designed to include the real property and the tangible personal property. The

Administrative Law Judge mentioned that the definition of tangible personal property excludes intangible assets. Although acknowledging the unique nature and extreme value attached to petitioner's characters, as an intangible asset, the Administrative Law Judge found that their value was properly excluded from petitioner's property factor for purposes of computing its BAP. The Administrative Law Judge further held that petitioner has not demonstrated any Commerce Clause or Due Process Clause violation as a result of the Division not including such intangible assets in the property factor.

With respect to the Commissioner's authority to grant a discretionary adjustment, the Administrative Law Judge concluded that petitioner was required to show much more than its ability to establish that its proposed methodology and formulas for apportioning its income to New York may be a more accurate or reasonable way to reflect its business activity in this state. Thus, the Administrative Law Judge determined that petitioner failed to sustain its burden to demonstrate that the Commissioner abused his discretion.

Next, the Administrative Law Judge addressed petitioner's argument that with respect to its royalty income from its licensing activities, petitioner 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. The Administrative Law Judge determined that petitioner failed to establish a basis for changing its original computation of royalty income from its licensing activities allocable to New York. The Administrative Law Judge noted that petitioner's original method of computing the numerator of its receipts factor based upon the New York business

location of its licensees is a reasonable methodology. The Administrative Law Judge rejected petitioner's 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. In his review of a sample license agreement, the Administrative Law Judge maintained that petitioner's licensing fees were calculated based upon a percentage of the licensee's net invoiced billings on sales and is not related to the amount of goods manufactured.

Lastly, the Administrative Law Judge rejected petitioner's argument that the film masters should be included in the property factor at their fair market value instead of at a value equal to their original cost. The Administrative Law Judge reasoned that most of the value ascribed to the film masters represents the value of the right to reproduce the films for sale in the consumer market. The Administrative Law Judge stated that this copyright represents an intangible asset. Since there is no legal requirement that intangibles should be factored into the apportionment formula, the Administrative Law Judge concluded that the expert's fair market value cannot be included in petitioner's property factor.

ARGUMENTS ON EXCEPTION

Petitioner disagrees with the Administrative Law Judge's conclusion that a plain reading of Public Law 86-272 demonstrates that the statute is inapplicable herein. Petitioner argues that Video is a nontaxpayer which is protected from the imposition of the Article 9-A tax in New York by Public Law 86-272 because the activities in New York performed by and on behalf of Video did not exceed the solicitation of orders for sales of tangible personal property.[19]

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[19]This exception is limited to Buena Vista Home Video only. Petitioner has expressly stated that the activities of the other two members of the Disney combined group, i.e. Walt Disney Catalog, Inc. and Childcraft, Inc. are not discussed herein because petitioner has chosen not to protest the determination that their receipts should

(continued...)

Furthermore, petitioner asserts that the synergistic relationship between Video and the other members of the Disney group has no bearing on whether Video's New York factors should be included in the numerators of the combined group's BAP. Rather, petitioner argues that the existence of a synergistic relationship has a direct implication concerning the filing of a combined report.

Lastly, petitioner disagrees with the Administrative Law Judge's conclusion that most of the value represented by the film masters is an intangible asset. Petitioner claims that the masters are tangible personal property. Petitioner states that by definition, the fair market value of all tangible personal property includes the rights that the owner of the property has with respect to that property. As such, petitioner alleges that the property factor of petitioner's BAP should be adjusted to reflect the fair market value of the film masters.

The Division, in its exception, disagreed with some of the characterizations made by the Administrative Law Judge in summarizing the Division's position in reaching his ultimate determination. Thus, the Division does not take exception to the ultimate outcome of the determination below, but rather, excepts to certain reasoning and analysis by the Administrative Law Judge below.

Specifically, the Division argues that reference to the New York activities of the combined group by the inclusion of the non-nexus companies' factor value in the combined reports BAP was not taxation of those values and was necessary in order to determine the tax liability of the combined group's taxpayer members. The Division emphasizes that it is only the taxpayer members of petitioner that bear any increase in the tax base caused by the inclusion of the non-

[19](...continued)
be included in the numerator of the Disney combined group's receipts factor (***see***, Petitioner's brief in support, p. 1).

nexus companies' New York sales in the numerators of the receipts factors of the combined reports. Thus, since it is only the taxpayer members that bear any increase in the tax base, it necessarily follows that Public Law 86-272 does not apply.

With respect to the valuation of the film masters, the Division states that it had made additional arguments below on this issue and wants its arguments preserved here on exception. Specifically, the Division claims that the valuation study of petitioner's film library did not establish the fair market value for the film negatives. Additionally, the Division asserted that petitioner had not proven that its method of valuing the film negatives should be changed from the method it originally used.

OPINION

We affirm the determination of the Administrative Law Judge.

The heart of this decision involves Public Law 86-272 and whether it applies in this case. The statutory provision states, in pertinent part, that:

> 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).

Petitioner states that, since this provision exempts from income-based taxes a corporation doing business in the state, Congress mandated economic distortion whenever Public Law 86-272 applies. Petitioner focuses its argument on whether the Division can "void that Congressionally sanctioned distortion and circumvent the federal protections merely because BVHV is included in a combined report" (Petitioner's brief in support, p. 2).

As both parties have noted, we addressed this issue expressly in the ***Matter of Alpharma, Inc.*** (Tax Appeals Tribunal, August 5, 2004) wherein we held:

> To properly reflect income, an apportionment formula (i.e., the business allocation percentage) is utilized. It determines the tax liability of the combined group's *taxpayer* members by reference to the in-state activities of the combined group (***see***, Tax Law § 211[4]; ***Matter of U.S. Trust Corp.***, Tax Appeals Tribunal, April 11, 1996; ***see also***, ***Matter of British Land [Maryland], Inc.***, Tax Appeals Tribunal, September 3, 1992). The apportionment formula is just that: a formula. It does not give New York State jurisdiction to tax. Only the portion of the total income of petitioner's combined report that is allocated to New York is subject to New York State taxation. The inclusion of the sales in the numerator of the receipts factor is necessary to arrive at the appropriate business allocation percentage. The inclusion of the sales is not an imposition of tax upon those sales of the nontaxpayer members of the group (emphasis added).

Video is a nontaxpayer member of the combined group. The BAP in this case determines the tax liability of the combined group's taxpayer members. Thus, as in ***Alpharma***, we reject petitioner's argument herein that Public Law 86-272 is being violated. The inclusion of sales in the numerator of the combined group's BAP is not an imposition of tax on sales by the nontaxpayer members such as Video.

The next issue to address involves the valuation of the film masters and whether such fair market value should be included in the combined group's property factor for its BAP.

In New York, the BAP 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 the 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.

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. Petitioner disagrees with the Administrative Law Judge's determination that failed to include the fair market value of the film negatives in the property factor. The Administrative Law Judge concluded that the property factor was defined by statute to include both real property and tangible personal property of the taxpayer which excludes intangible assets (***see***, Tax Law § 208[11]). The Administrative Law Judge stated that a large portion of the value attributed by Mr. King for the film negatives was the value of the

right to reproduce the films for sale. This right as characterized by the Administrative Law Judge represented an intangible asset that is not permitted to be included in the property factor.

Petitioner argues that whenever an item of tangible personal property is to be valued for purposes of the property factor, the value associated with any related intangible rights cannot be removed. Petitioner states that tangible personal property is valued by the marketplace by taking into account the uses that can be made of the property because the usage of the property determines its value. Thus, petitioner claims that the "fair market value of any asset necessarily reflects the uses to which it can be put" (Petitioner's brief in opposition, p. 22).

We reject petitioner's argument. As thoroughly analyzed by the Administrative Law Judge, it is clear that for New York tax purposes, the value of an intangible asset cannot be included in the property factor of the combined group's numerator for its BAP. Petitioner has not provided any case law demonstrating its position which is in direct contradiction of the statute. As noted by the Division in its brief, petitioner did not take an exception to the conclusions of law wherein the Administrative Law Judge determined that intangible assets are excluded when determining the property factor. Since this is the basis for our decision, we need not address the issue of whether Mr. King's report properly established a fair market value for the film library.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Disney Enterprises, Inc. & Combined Subsidiaries is denied;

2. The exception of the Division of Taxation is granted to the extent Public Law 86-272 is inapplicable to the facts herein based upon the reasoning in ***Matter of Alpharma, Inc.*** (***supra***), but is otherwise denied;

3. The determination of the Administrative Law Judge is affirmed;

4. The petition of Disney Enterprises, Inc. & Combined Subsidiaries is denied;

5. Petitioner's claim for refund is denied; and

6. The Notice of Deficiency dated November 30, 2000 is sustained.

DATED: Troy, New York
October 13, 2005

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner