STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ALPHARMA, INC.	:	DETERMINATION DTA NO. 817895
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1993, 1994 and 1995.	:	

Petitioner, Alpharma, Inc., One Executive Drive, Fort Lee, New Jersey 07024-1399, 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 years 1993, 1994 and 1995.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 8, 2001, at 10:30 A.M., and continued to its conclusion at the same location on May 9, 2001 at 9:00 A.M., with all briefs to be submitted by March 18, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by McDermott, Will & Emery (Arthur R. Rosen, Esq. and Alysse Grossman, Esq. of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Clifford M. Peterson, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation has properly imposed corporation franchise tax on the Alpharma Group nontaxpayer corporations[1] by including the New York destination sales of such

[1] The corporations which comprised the Alpharma Group non-taxpayers, around which this matter is centered, are Able and Barre-National in 1993; Able, Barre-National and Wade Jones in 1994; and Alpharma and Barre-National in 1995.

corporations in the numerator of the receipts factor of the business allocation percentage of the combined group, or whether such sales of nontaxpayer corporations are immune from New York corporation franchise tax due to the protections afforded by the Commerce Clause of the United States Constitution or by Public Law No. 86-272.

II. Whether New York improperly exercised jurisdiction over the nontaxpayer corporations of the unitary group.

III. If there is no jurisdictional issue to overcome, whether the subject receipts must be included in the numerator of the receipts factor used in the apportionment formula in order to avoid distortion.

FINDINGS OF FACT

The parties entered into a stipulation of facts which are incorporated into the Finding of Facts set forth below.

1. The Division of Taxation ("Division") issued Notice of Deficiency #L-017607509-9 ("Notice"), dated April 17, 2000, to Alpharma, Inc. ("Alpharma"), asserting additional corporation franchise taxes for tax years 1993, 1994 and 1995. The total additional tax asserted in the Notice was $173,858.00, plus interest and penalty in the amount of $78,662.05 and $28,828.50, respectively, for a total of $281,348.55. The adjustments that resulted in the additional tax liability asserted on the Notice for the years 1993 and 1994 did not result from sales of shipments of tangible personal property to points within New York State and are not being contested in this proceeding. The subject Notice does include, however, an adjustment to the numerator of the receipts factor based on the Division's position that petitioner incorrectly excluded from the numerator, the receipts from the sales that resulted from shipments to points within New York State.

2. On or about January 30, 1992, Alpharma (formerly known, at different times, as A.L. Laboratories, Inc. and A. L. Pharma Inc.) corresponded with the Division requesting permission to file a combined report with some of its subsidiaries pursuant to the franchise tax regulations for the year ending December 31, 1991 and subsequent years ("initial request"). The letter, prepared by Robert A. Pudlak, then Vice President, Finance and Chief Financial Officer (who was transferred to Able Laboratories after October 1992), established that A.L. Laboratories, Inc. (petitioner herein) owned directly 100% of the stock of G. F. Reilly Company (incorporated in Delaware), A.L. Specialty Chemicals, Inc. (incorporated in Illinois), ParMed Pharmaceuticals, Inc. (incorporated in Delaware), Barre Parent Corporation (incorporated in Delaware), Biomed (incorporated in Washington), and NMC Laboratories, Inc. (incorporated in New York). Further, Barre Parent owned directly 100% of the stock of Barre-National, Inc. (incorporated in Maryland). The correspondence concluded that the capital stock requirement for combined filing was met.

Concerning the unitary business requirement of 20 NYCRR 6-2.2(b), the initial request set forth the following information concerning the relationship between the corporations:

A.L. Laboratories, Inc.

> A.L. Laboratories, Inc. consists of two divisions, one which manufactures and sells animal health products ("Animal Health") and the corporate division which is directly involved with the management of all subsidiaries and the Animal Health division. These management activities performed on behalf of subsidiaries and Animal Health include among others, the selection of key executive personnel, certain research and development, budgeting, treasury, legal, financing, compensation and major decision making (such as approval of large expenditures and approval of subsidiaries marketing plans). In certain cases, individuals performing full-time management services for subsidiaries are employees of A.L. Laboratories, Inc. and are directly compensated, supervised and controlled by the parent.

G. F. Reilly Company

G. F. Reilly Company ("Reilly") has unitary ties with the parent and a subsidiary of the parent. G. F. Reilly owns a building in Maryland. Reilly is contractually obligated to lease that building (its principal asset) to Barre-National, Inc. who is a second tier subsidiary of the parent. In fact, in 1991 100% of Reilly's taxable income was derived from rental receipts obtained from Barre-National Inc. Unitary ties with the parent are evidenced by the fact that Reilly has no employees; all decisions with respect to Reilly are made by executives of A. L Laboratories, Inc. many of whom are also non-compensated officers of Reilly.

A. L. Specialty Chemicals, Inc.

A. L. Specialty Chemicals, Inc. ("Specialty") is unitary with the parent due to its usage of A. L. Laboratories, Inc.'s manufacturing facilities and employees in Illinois. In addition, most officers of Specialty are also executives of the parent. Since Specialty has no employees of its own, all decisions including those affecting Specialty's day-to-day operations are made by A. L. Laboratories, Inc.

ParMed Pharmaceuticals, Inc.

ParMed Pharmaceuticals, Inc. ("ParMed") has unitary ties since it provides backup computer storage capacity for the parent and certain subsidiaries. An employee of the parent (Director of MIS) oversees ParMed's computer operations. Furthermore, NMC Laboratories, Inc. ("NMC") a subsidiary of the parent, utilizes ParMed facilities for virtually all their computer needs. An attempt is made to recover ParMed's costs for computer services in the form of intercompany charges, however, there is no profit element; this represents a distortion.

Other unitary ties between ParMed and certain affiliates include intercompany purchases of pharmaceutical products and related product lines. For instance, substantially all of ParMed's liquid and dermatological products are supplied by Barre and NMC, respectively. The parent, as with other subsidiaries, also exerts an overwhelming amount of control over ParMed in areas such as financing, budgeting, choice of key executives and major decision making.

Barre Parent Corporation

Barre Parent Corporation ("Barre-Parent") has no income or expenses. Barre-Parent's purpose is to hold the stock of Barre-National, Inc. ("Barre"). As discussed below, Barre clearly has a unitary relationship with A. L. Laboratories, Inc. and certain affiliates. In our opinion, the unitary ties of Barre and the relationship between Barre-Parent and its subsidiary would satisfy the unitary requirement for both companies.

Barre-National, Inc.

Barre-National, Inc.'s unitary relationship with A.L. Laboratories, Inc. and certain affiliates is evidenced by intercompany sales, an intercompany lease, common officers, common customers and an evolving common sales force. Intercompany sales are made between Barre and ParMed and between NMC and ParMed. As mentioned previously, there is an intercompany lease between Reilly and Barre (Barre leases its manufacturing facility in Maryland from Reilly). Some of the officers of Barre are also officers of A. L. Laboratories, Inc. and NMC. In fact, George Barrett, who is the president of NMC and Barre, divided his time almost equally in 1991 among both companies. NMC and Barre manufacture and sell human pharmaceuticals. ParMed sells human pharmaceuticals. The operations of Barre and NMC are closely integrated as evidenced by certain common customers (including ParMed) and common management.

Biomed, Inc.

Biomed, Inc. ("Biomed"), has a unitary relationship with the parent. Biomed develops, manufactures and markets bacterins used to immunize fish against disease while A.L. Laboratories, Inc.'s Animal Health Division manufactures and markets feed additives and antibiotics for poultry and swine. Thus, both companies are in a related line of business. In fact, Mr. Robert Busch who is the vice president and general manager of Biomed, reports directly to Mr. David Cohen who is the president of the parent's Animal Health Division. Mr. Busch also participates in the parent's compensation package. As with other subsidiaries, the parent exerts control over Biomed in areas such as legal, treasury, financing, budgeting, hiring of key executives and major decision making. Biomed also relies heavily upon Animal Health for financial reporting assistance and utilization of computer facilities. In fact, Animal Health Division and Biomed are combined for financial segment reporting purposes.

NMC Laboratories, Inc.

NMC has unitary relationships with the parent, with Barre and ParMed. Some of the unitary ties, as mentioned previously, include a common president (Barre and NMC), intercompany sales and purchases and utilization of ParMed's computer services. NMC uses ParMed's facilities for a significant amount of their computer needs. In addition, the parent exercises unitary control over NMC as with all of its subsidiaries by making major decisions, overseeing operations, hiring certain executives and approving budgets and major expenditures. A. L. Laboratories, Inc. also guarantees NMC's line of credit.

After concluding that the unitary business requirement was met, petitioner asserted that filing on a separate basis would distort the activities, business income and capital in New York State. The correspondence stated that:

> Distortion would be attributed not only to intercorporate transactions but also to the value which flows between members of the affiliated group, as evidenced by the following:
>
> - Management, control and direction of the affiliated group are critical activities performed by the Board of Directors and Officers of A. L. Laboratories, Inc.
>
> - Expenses of the parent including legal, treasury, financing, stewardship, accounting, certain payroll expenses, tax preparation, risk management, business development, certain research and development and other expenses incurred at the headquarters are not allocated to subsidiaries which causes an overstatement of income for subsidiaries and an understatement of the parent's income.
>
> - An attempt is made to reimburse ParMed for computer storage services (discussed above) provided to other members of the Group. However, the intercompany charges made by ParMed to other members of the Group are not designed to yield an arm's-length profit but rather are designed to cover ParMed's cost.
>
> - Amongst all of A. L. Laboratories, Inc.'s companies, there is a sharing of development capabilities and operating technologies. For example, NMC is in the process of obtaining FDA approvals on three new dermatological formulas that are expected to be made available to ParMed which will cause a distortion of income and expenses between those companies.
>
> In summary, the distortion requirement is satisfied due to the overwhelming synergy between the companies. The close interrelationships of the companies and integration of their businesses have given rise to a variety of intercompany transactions which makes it extremely difficult to determine the accurate computation of income on a separate company basis. Only a combined return can correct such distortions.

3. By correspondence dated March 13, 1992, the Division granted tentative permission to Alpharma (then known as A.L. Laboratories, Inc., EIN 22-2095212) and the subsidiaries listed below, to file a combined report commencing with the period ending December 31, 1991:

A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Barre-National, Inc.	EIN 52-0577546
Biomed, Inc.	EIN 91-1089227
G. F. Reilly Company	EIN 22-2509324
NMC Laboratories, Inc.	EIN 11-2566658
ParMed Pharmaceutical, Inc.	EIN 16-1276038
Barre Parent Corporation	EIN 34-1536575

4. Alpharma filed a combined report including the subsidiaries listed in its initial request ("1991 Alpharma Group"), for purposes of the tax imposed by Article 9-A of the New York State Tax Law (the "Article 9-A tax"), for the year ending December 31, 1991. The 1991 Alpharma Group consisted of the following companies:

A.L. Laboratories, Inc. (petitioner herein)	EIN 22-2095212
A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Barre-National, Inc.	EIN 52-0577546
Biomed, Inc.	EIN 91-1089227
G. F. Reilly Company	EIN 22-2509324
NMC Laboratories, Inc.	EIN 11-2566658
ParMed Pharmaceutical, Inc.	EIN 16-1276038
Barre Parent Corporation	EIN 34-1536575

5. Alpharma filed a combined report including certain of the subsidiaries (detailed *infra*), for purposes of the tax imposed by the Article 9-A tax, for each of its tax years, 1993, 1994 and 1995.

The 1993 Alpharma Group

6. Alpharma, together with the subsidiaries included in the combined report it filed for 1993, will be referred to as the "1993 Alpharma Group." The 1993 Alpharma Group consisted of :

Alpharma	EIN 22-2095212
A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Able Pharmaceutical, Inc.(also known as Able Laboratories, Inc.)("Able"[2])	EIN 22-3192695
Alpharma USPD, Inc.(also known as Barre-National, Inc.) ("Barre-National"[3])	EIN 52-0577546
Alpharma NW Inc. ("NW")(formerly known as Biomed, Inc.)	EIN 91-1089227
G. F. Reilly Company ("Reilly")	EIN 22-2509324
NMC Laboratories, Inc. ("NMC")	EIN 11-2566658
ParMed Pharmaceuticals, Inc. ("ParMed")	EIN 16-1276038

For the members of the 1993 Alpharma Group that were included in the initial request and the1991 Alpharma Group, their inclusion in the 1993 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State, such that it would be "extremely difficult to determine the accurate computation of income on a separate company basis").

Able was not a subsidiary included in the 1991 Alpharma Group. The inclusion of Able in the 1993 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2 (b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State).

7. Specialty Chemicals, Able, Barre-National, NW and Reilly were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1993. These subsidiaries

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[2] For consistency throughout the determination, and to eliminate any confusion, Odin Pharmaceutical, Inc., which was also known as Able Laboratories, Inc. will be referred to as "Able."

[3] For consistency throughout the determination, and to eliminate any confusion with the United States Pharmaceutical Division, references to "USPD," where intended to refer to Barre-National, will be replaced by the corporate name Barre-National.

did not pay the fixed minimum tax on the combined return nor has the Division asserted that they should pay the fixed minimum tax.

The 1994 Alpharma Group

8. Alpharma, together with the subsidiaries included in the combined report filed for 1994, will be referred to as the "1994 Alpharma Group." The 1994 Alpharma Group consisted of:

Alpharma	EIN 22-2095212
Specialty Chemicals	EIN 36-3374030
Able	EIN 22-3192695
Barre-National	EIN 52-0577546
NW	EIN 91-1089227
Reilly	EIN 22-2509324
NMC	EIN 11-2566658
ParMed	EIN 16-1276038
Alpharma Animal Health Company ("Wade Jones") (also known as "Animal Health")[4]	EIN 75-1763319

For the members of the 1994 Alpharma Group that were included in the initial request and the 1991 Alpharma Group, their inclusion in the 1994 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

9. Wade Jones was not a subsidiary included in the initial request and the 1991 Alpharma Group. The inclusion of Able and Wade Jones in the 1994 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

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[4] This company will be consistently referred to as "Wade Jones."

10. Specialty Chemicals, Able, Barre-National, NW, Reilly and Wade Jones were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1994. These subsidiaries did not pay the fixed minimum tax on the combined report, nor has the Division asserted that they should pay the fixed minimum tax.

The 1995 Alpharma Group

11. Alpharma, together with the subsidiaries included in the combined report it filed for 1995, will be referred to as the "1995 Alpharma Group." The 1995 Alpharma Group consisted of:

Alpharma	EIN 22-2095212
Specialty Chemicals	EIN 36-3374030
Able	EIN 22-3192695
Barre-National	EIN 52-0577546
NW	EIN 91-1089227
Reilly	EIN 22-2509324
NMC	EIN 11-2566658
ParMed	EIN 16-1276038
Wade Jones	EIN 75-1763319
Alpharma U.S. Inc. ("US")	EIN 22-3322528

For the members of the 1995 Alpharma Group that were included in the initial request and the 1991 Alpharma Group, their inclusion in the 1995 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State).

12. US was not a subsidiary included in the initial request and the 1991 Alpharma Group. The inclusion of Able, Wade Jones and US in the 1995 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

13. After October 3, 1994, all of the members of the 1995 Alpharma Group, other than Alpharma or US, were second or third tier subsidiaries of Alpharma. After October 3, 1994, a holding company known as A.L. Laboratories, Inc., which is a first tier subsidiary of Alpharma, was formed to hold the stock of the 1995 Alpharma Group, other than Alpharma and US. This structure is reflected on an organizational chart labeled "A.L. Pharma Inc. & Subsidiaries" with a handwritten note "After 10/3/94 Before 9/15/95." In 1995, A.L. Laboratories changed its name to Alpharma U.S. Inc. (US). While US and Alpharma have, at different times, shared the same name, i.e., A.L. Laboratories, Inc., they have always been separate entities.

14. Alpharma, Specialty Chemicals, Able, Barre-National, NW, Reilly, Wade Jones and US were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1995. These companies did not pay the fixed minimum tax on the combined report nor has the Division asserted that they should pay the fixed minimum tax.

15. During the audit, petitioner did not assert that the reasons for its filing a combined report as stated in the January 1992 correspondence had changed.

Alpharma and the Animal Health Division

16. During the years in issue, 1993 through 1995, Alpharma, Inc. ("petitioner" or "Alpharma"), the parent company, was primarily involved in the manufacture of pharmaceuticals for the animal health industry as well as the sale of fine chemicals in the United States. Fine chemicals are the active ingredients used in finished (human) pharmaceuticals.

17. From 1993 through 1995, petitioner did not lease or own any facilities in New York, or have any business equipment in New York. Alpharma's primary facilities were located in Fort Lee, New Jersey and Chicago Heights, Illinois. During the audit period, petitioner had one sales representative, whose office was located in Fort Lee, New Jersey, soliciting sales in

New York State who represented petitioner's Fine Chemical Division. His job was to call on customers in New York and present the products (about 10 of them) sold by petitioner. The targeted customers would be Pfizer, Burroughs-Wellcome, and other small generic manufacturers, all of whom manufacturer finished dose human pharmaceuticals. The salesperson did not have the authority to accept orders and did not employ the use of any type of display racks for the products. The sales orders were accepted in Fort Lee, New Jersey or in Europe where the manufacturing of such products took place.

In addition to the representative from the Fine Chemical Division, petitioner had another sales representative, Tom Wagner, the head of corporate information technology, who would visit New York a few times a year conducting business activities in the state. His office was located in Fort Lee, New Jersey and he spent about 20% of his time in New York and 20% of his time in New Jersey. While in New York, he would work out of the offices of ParMed, a subsidiary of petitioner, in Niagara Falls, New York. The balance of Mr. Wagner's time was spent overseas or in another of petitioner's subsidiaries in Baltimore, Maryland. Mr. Wagner's position was eliminated in 1994. It was on the basis of Mr. Wagner's part-time work in New York prior to1994 that petitioner considered itself a New York taxpayer for franchise tax purposes. The Division and petitioner agree that Alpharma was not a taxpayer in New York in 1995, but do not agree on the basis for petitioner's nontaxpayer status.

18. In 1992, when petitioner filed its request for permission to file on a combined basis for New York corporation franchise tax purposes, petitioner described itself as a parent company that consisted of two divisions, "one which manufacturers and sells animal health products ("Animal Health") and the corporate division which is directly involved with the management of all subsidiaries and the Animal Health division." Future annual reports and 10-K filings with the

Securities and Exchange Commission ("SEC") thereafter describe petitioner as a parent company "with two business segments, the Pharmaceutical segment and the Animal Health and Bulk Antibiotic segment" (***see***, SEC Form 10-K, 12/31/93), a parent company "with five operating divisions, three in Human Pharmaceuticals and two in Animal Health" (***see***, 1994 Annual Report) and a parent company "with five operating divisions included in two business segments, Human Pharmaceuticals and Animal Health" (***see,*** SEC Form 10-K, 12/31/95).

19. In July 1991, petitioner's board of directors established the office of the chief executive to assume the top management role of petitioner, and "to assure the continuity of the long-established direction and strategy of [petitioner]." The three-member office included Einar Sissener, chairman of the board and founder of A. L. Laboratories, I. Roy Cohen, vice chairman and former president and chief executive officer of the company from its inception until January 1991, and Jeffrey Smith, the executive vice president, described as having full operating responsibility for the company, and having played a key role in refining and executing petitioner's strategy since 1984 as vice president of finance and chief financial officer. In 1993, petitioner's management was strengthened by Sissener's acceptance of greater responsibility for petitioner's operations within the office of the chief executive. Both Sissener and Smith held their named positions in the office of the chief executive from July 1991 through May 1994.

20. In the 1992 Annual Report, Sissener, Smith and Cohen are depicted as working closely with the senior management of each of the specialty businesses, particularly, David Cohen, president of Animal Health, and George Barrett, president of Barre-National and NMC. The report stated that:

> This *ongoing interchange* assures continued reassessment of strategies in the context of our long-standing philosophy, evaluation of new opportunities, and a *critical analysis of business activities*, which facilitates the most efficient use of our global capabilities (emphasis supplied).

21. In 1992, a special committee of petitioner's board of directors was appointed to evaluate the feasibility of combining petitioner with the related pharmaceutical, animal and aquatic health and bulk antibiotic businesses of a Norwegian corporate group. During 1993, the special committee together with petitioner's management and the board of directors, discussed various proposed structures and terms of a transaction in which the related businesses would become part of petitioner. As set forth in petitioner's SEC Form 10-K filing for the period ended December 31, 1994, on October 3, 1994, petitioner completed the transaction in which it acquired the pharmaceutical, bulk antibiotic, animal health and aquatic animal health businesses of a Norwegian company, hereinafter referred to as the "combination transaction." Subsequent to the combination transaction, petitioner was reorganized into five operating divisions which included two business segments, Human Pharmaceuticals and Animal Health. The Human Pharmaceuticals segment consists of three operating divisions, U.S. Pharmaceuticals, International Pharmaceuticals and Fine Chemicals. The Animal Health segment consists of two operating divisions, Animal Health and Aquatic Animal Health.

As reported in petitioner's SEC Form 10-K for 1995, after the closing of the combination transaction, each division was required to evaluate its business to determine actions necessary to maximize the division's and petitioner's competitive position. As a result, in December 1994, petitioner's board of directors approved a plan and petitioner announced post-combination management actions which included exiting certain businesses and product lines which did not fit into petitioner's new strategic direction, severing certain employees employed in the businesses or product lines to be exited or whose positions had become redundant as a result of the acquisition and the sale or exiting of certain support facilities also found to be redundant.

22. Petitioner's management made a variety of other major decisions concerning acquisitions of other companies by petitioner. In 1992, petitioner acquired Able Laboratories, Inc. which became part of its Human Pharmaceuticals group. In 1994, petitioner acquired Wade Jones as part of its Animal Health segment and such acquisition was considered a noteworthy event by petitioner's 1994 Annual Report. Petitioner reported that:

> In addition to being the largest poultry animal health products distributor in the United States, Wade Jones develops, manufactures and sells its own line of animal health products. These products complement and significantly enhance the breadth of our water soluble product line. . . In total, the Wade Jones acquisition should add over $20 million in sales in 1995.

Wade Jones distributed products for Alpharma as a warehousing and trucking company, but did not solicit sales for petitioner. Petitioner did not solicit sales for Wade Jones. Approximately 90% of all products sold by the Animal Health Division in the United States in 1995 to the poultry industry were distributed by Wade Jones.

23. Petitioner's animal health care products were sold primarily to the poultry and swine industries. Within the poultry industry, the customers were typically the large integrated producers of poultry products, such as Tyson, Purdue and Conagra, located in the poultry belt from Maryland, south to Georgia and west to Arkansas. As to the swine industry, products similar to those sold to the poultry industry were sold to pork producers through distributors in Iowa, North Carolina and parts of the mid-west.

24. Petitioner performed services for its subsidiaries with regard to finances, insurance, general management, approval of overall budgets, centralized legal services and risk management. Petitioner maintained two qualified noncontributory defined benefit pension plans covering the majority of its domestic employees. Petitioner set the pension plans' funding policies, determined the plans' investment manager and set the general investment direction.

Petitioner's involvement with the subsidiaries' marketing plan was to the extent of the annual budget review. Major decisions, such as the acquisition of Able and Wade Jones, and significant capital expenditures required approval of petitioner's upper management or board of directors. Alpharma purchased insurance coverage for the members of the combined group to attain more favorable rates and coverage. There were common officers among the subsidiaries and petitioner, who were not compensated by the subsidiaries. Alpharma was not provided any reimbursement by the subsidiaries for the services of the officers.

Alpharma was responsible for the generation of its own working capital in the profitable animal health business. For the years in issue, Alpharma provided a parent company guarantee for the debts of its subsidiaries, which resulted in lower lending margins and longer term financing arrangements for the subsidiaries, particularly Barre-National, NMC, ParMed and Able. Albert Marchio, petitioner's treasurer, was directly involved with the negotiation of the credit facilities appropriate for the subsidiaries. The subsidiaries were not charged any fees for the services provided by the parent, Alpharma.

25. Petitioner's involvement with the pharmaceutical regulatory environment was described in petitioner's SEC Form 10-K for 1995 as follows:

> Since 1989 the U. S. pharmaceutical industry has been, and continues to be, subject to an intense level of scrutiny by the FDA [U.S. Food and Drug Administration] and by members of Congress. As a result of actions taken by [petitioner] to respond to the progressively more demanding regulatory environment in which it operates, the operating income of the USPD's operations has been negatively affected. *[Petitioner] has spent, and will continue to spend, significant funds and management time on FDA compliance matters.* In 1992 Barre concluded a binding agreement in the form of a consent decree with the FDA which clarified Barre's regulatory obligations (the 'Consent Decree'). The Consent Decree defines the standards Barre must achieve in meeting Current Good Manufacturing Practices ('CGMP'). In addition, USPD's Able operation is also a party to an amended consent decree with the FDA governing manufacturing operations in accordance with CGMP. In this regard, Able has engaged in extensive regulatory compliance activities which have included

> discontinuing certain products and making capital expenditures and increasing operating expenditures for quality assurance and control (emphasis supplied).

26. During the 1993 strengthening of petitioner's management, Beth Hecht was appointed corporate counsel and secretary. As general counsel, she spent about 20% of her time on the U.S. Pharmaceutical Group ("USPG") (Barre-National, ParMed, NMC and Able) concerns, particularly issues relating to intellectual property matters, which was her field of expertise. She spent about 15% of her time on non-US subsidiaries and the remaining 65% of her time was shared in connection with mergers and acquisitions of other companies, general corporate activities and animal health concerns. She remained corporate counsel for the entire audit period.

27. During the audit years, and prior thereto, petitioner's animal health business was very profitable, more so than the human pharmaceuticals group, and as such, funded the acquisitions of ParMed in 1985, Barre-National in 1987, NMC and Biomed in 1990, and Able in 1992. However, during the audit period, Alpharma, whose focus was the animal health business, did not solicit sales on behalf of Able, Barre-National, or NMC, which were all human generic pharmaceutical manufacturing companies.

Human Pharmaceuticals Division

28. For the audit period, the portion of the Human Pharmaceuticals Division that is of concern involved the U.S. operations only, comprised of four wholly-owned subsidiaries of petitioner: Barre-National, NMC, Able and ParMed. In 1993, Barre-National and the USPG, occupied a 255,000 square-foot manufacturing, warehouse and office facility in Baltimore, Maryland, and an 82,000 square-foot facility in Lincolnton, North Carolina, which was acquired by Barre-National in March 1993 and used for the same purpose. Barre-National had no employees in New York and no owned or leased facilities of its own in New York. By 1995,

properties of the same or larger size and in the same location were considered manufacturing and headquarters for petitioner's United States Pharmaceutical Division ("USPD")[5], and manufacturing and office space for the USPD, respectively. The Lincolnton facility space had been expanded by more than 50% during the audit period.

In 1993, NMC occupied 78,000 square feet of manufacturing, warehouse and office space leased by petitioner in Glendale, New York, which space, by 1995 was used for manufacturing and offices by the USPD. NMC was a New York taxpayer for the audit period.

In 1993, ParMed occupied a 30,000 square foot warehouse and office facility in Niagara Falls, New York, which was owned by petitioner. By 1995, a facility of the same size and space was utilized by the USPD for warehouse and office space. ParMed was a New York taxpayer for the audit period.

In 1993, Able occupied 60,000 square feet of manufacturing, warehouse and office space leased by petitioner in South Plainfield, New Jersey, which space, by 1995, was used for manufacturing and offices by the USPD. Able had no employees in New York and no leased or owned facilities of its own in New York.

29. The SEC required 10-K filing for petitioner, then called A.L. Laboratories, Inc., for the year ended December 31, 1993 described petitioner, "the Company," as follows:

> [Petitioner] is an international pharmaceutical company engaged in developing, manufacturing and marketing specialty generic and proprietary human pharmaceuticals, animal health products and bulk antibiotics.
>
> The Company has two business segments. The Pharmaceutical segment consists of the U.S. Pharmaceutical Group and the Pharmaceutical and Oral Health Care businesses of the Company's wholly owned Danish subsidiary, Dumex Ltd. ("Dumex"). The Animal Health and Bulk Antibiotic Segment

[5] After the combination transaction in October 1994, the four subsidiaries which comprised petitioner's U.S. Pharmaceutical Group became the United States Pharmaceutical Division, or USPD.

consists of the Company's Animal Health division, Biomed, Inc. ("Biomed") and Bulk Antibiotic business conducted by Dumex.

Pharmaceuticals

In the United States, the Company conducts a specialty generic pharmaceutical business through its U.S. Pharmaceutical Group ("USPG"). The USPG whose activities are managed by a single senior management team, is comprised of four wholly-owned subsidiaries, Barre-National, Inc. ("Barre"), NMC Laboratories, Inc. ("NMC"), Able Laboratories, Inc. ("Able") and ParMed Pharmaceuticals, Inc. Barre, acquired in October 1987, is the leading U.S. manufacturer of liquid generic pharmaceutical products. Barre manufactures approximately 200 products which are marketed nationally primarily under the "Barre" label to pharmaceutical distributors and wholesalers and retail drug chains. NMC, acquired in August 1990, is a specialized pharmaceutical manufacturer and marketer of over 45 creams and ointments for topical use, primarily prescription products. Able, acquired in October 1992, is a manufacturer and marketer of specialized prescription and over the counter pharmaceuticals with an emphasis on suppositories, as well as dermatological creams and specialty tablets. ParMed, acquired in May 1986, markets nationally primarily under the "ParMed" label a broad line of generic pharmaceuticals. ParMed has its products contract manufactured by drug manufacturers and sells primarily to independent retail pharmacists utilizing advanced telemarketing techniques.

In March, 1993, Barre, acquired a pharmaceutical manufacturing facility in Lincolnton, North Carolina ("Lincolnton"), including inventories, approved Abbreviated New Drug Applications ("ANDA") and other related assets. The facility is designed to manufacture oral liquids and topical ointments and creams.

* * *

The manufacture and sale of pharmaceuticals constitutes the Company's largest business segment.

* * *

Barre

In the United States, through Barre, the Company is the leading manufacturer of generic pharmaceutical products in liquid form. . . Barre manufactures its products in a modern 255,000 square foot facility in Baltimore, Maryland. . . Barre markets nationwide to pharmaceutical distributors, merchandising chains and wholesalers primarily under the "Barre" label through independent sales representatives and in recent years a combined U. S. Pharmaceutical sales force. . . In March 1993, Barre, acquired the Lincolnton manufacturing facility. The Lincolnton facility presently compliments both NMC and Barre in that it

produces both liquids, creams and ointments. The USPG expects future productive capacity increases and/or the possible realignment of productive capacity for certain of its product line will be located at Lincolnton.

NMC

[N]MC manufacturers its products in leased facilities in Glendale, New York. . . NMC markets nationwide mainly to wholesalers and drug chains principally under the "NMC" label. NMC coordinates its sales effort as part of the USPG.

* * *

Able

[A]ble products are marketed through the combined USPG sales force and independent sales representatives nationwide to drug chains and distributors primarily by manufacturing private label products for the drug chains and distributors. Able manufactures its products in leased facilities in South Plainfield, New Jersey.

ParMed

A line of over 300 generic prescription and over-the-counter pharmaceutical products is distributed primarily under the "ParMed" label in the United States through ParMed, which was acquired in May 1986. The largest part of ParMed's sales are made to independent retail pharmacists in the United States. A substantial majority of ParMed's sales are made through a 40 person sales force utilizing advanced telemarketing techniques. ParMed's telemarketing program is reinforced by a direct mail program to independent retail pharmacists. ParMed's products are contract manufactured by drug manufacturers who package and label products to ParMed specifications. Most products are available from more than one source. ParMed also markets Barre, Able and NMC branded products as part of its overall strategy.

ParMed's 30,000 square foot warehouse facility and offices are located in Niagara Falls, New York.

30. Petitioner's 1993 Annual Report included the following information concerning the USPG:

To better serve the U.S. pharmaceutical market and further strengthen the Company's competitive posture, we consolidated all of our U.S. generic pharmaceutical operations under one senior management team headed by George Barrett. The formation of the U.S. Pharmaceutical Group represents an

> important element of our strategy to benefit from the many leveraging opportunities in our existing business while more efficiently serving our customers.
>
> * * *
>
> During the year our U.S. Pharmaceutical research and development activities were centralized in a new facility at the Bayview campus of Johns Hopkins University. This facility provides the expansion necessary to pursue continued market leadership in liquid and topical pharmaceuticals, and expand our presence in suppositories, aerosol inhalants and other targeted specialty markets.
>
> * * *
>
> U.S. Pharmaceutical Group operations posted strong revenue growth, with volume increases at our Barre-National, NMC and ParMed subsidiaries.

31. After the combination transaction in October 1994, the United States Pharmaceutical Group became known as the United States Pharmaceutical Division ("USPD"), and was comprised of the same four wholly-owned subsidiaries: Barre-National, NMC, Able and ParMed. During the formation of the USPD, management took a number of consolidating actions. NMC, Barre-National and Able, the companies involved in the manufacture of human pharmaceuticals (ParMed was the only nonmanufacturing company in the USPD), reorganized and began to combine their marketing activities rather than continue operating as three separate companies in that regard. The result was a combined sales effort and a centralized inventory and distribution center under Barre-National. NMC and Able manufactured products for sale to Barre-National pursuant to a contract manufacturing arrangement, which then, in turn, sold to the customer. After the reorganization, neither NMC nor Able had any sales representatives. The customers they were selling to were primarily CVS and Walgreen's, located in Massachusetts and Illinois, respectively.

The sales representatives both before and after the reorganization would call on a buyer of a pharmaceutical company, present a product list, talk about pricing and service. However,

the salesperson did not have the authority to accept orders. The orders were accepted in and the goods shipped from each of the manufacturing sites, and later, Columbia, Maryland. NMC, Able and Barre-National shipped goods into New York to distribution centers of the various pharmaceutical companies which were located across the country.

32. In petitioner's 1991 Annual Report, ParMed is said to have:

> [S]uccessfully applied the talents of its creative marketing staff to support Barre and NMC. Marketing strategies included implementation of an *ongoing Barre/NMC promotional program*, the targeting of special customer groups, and the support of an aggressive direct mail campaign to enhance consumer awareness and pharmacists' product knowledge. This represents a further example of the synergies between our U. S. pharmaceutical subsidiaries (emphasis supplied).

Petitioner's 1992 Annual Report demonstrates similar continuity of the synergies described above:

> In the first half of the year, a dedicated sales force was formed to more efficiently serve the overlapping customer base of our U.S. special liquids and topicals business (referring to Barre-National and NMC). As a result, NMC, our dermatologicals subsidiary, continued to increase penetration of its market segment helping to offset Barre's temporarily lowered sales. Complementing this combined Barre/NMC sales and marketing effort, ParMed Pharmaceuticals applied its sophisticated telemarketing skills and specialized programs to extend the visibility of Barre, NMC and Able products.
>
> * * *
>
> The creation of a Barre and NMC joint sales and marketing organization, launched during 1992, has been one our major strategic initiatives, and is already having a positive impact on our business. At the same time we have been able to integrate the sophisticated telemarketing capabilities of ParMed by utilizing their services to support the market efforts of our pharmaceutical operations.

Likewise, in the SEC Form 10-K for 1995, ParMed is praised:

> Through its ParMed operation, the USPD distributes a line of over 1800 generic prescription and over-the-counter pharmaceutical product presentations and offers certain custom marketing services (such as telemarketing, order processing and distribution) to the pharmaceutical industry. The largest part of ParMed's sales are made to U.S. independent retail pharmacies. A substantial majority of ParMed's sales are made through a 45 person telemarketing sales

> force. ParMed's products are manufactured by drug manufacturers who package and label products for ParMed. ParMed also markets products bearing the "Barre", and "NMC" labels. In addition, a special group of telemarketers is dedicated to marketing USPD products to retailers and institutional pharmacies (such as those in nursing homes).

33. During the audit period, and prior to the restructuring of the USPG to the USPD, Barre-National, NMC and Able sold their products to the related entity, ParMed, which telemarketed the products to over 6,000 independent pharmacies nationwide. According to the 1994 SEC Form 10-K, through its ParMed operation, the USPD distributed a line of over 1,800 generic prescription and over-the-counter pharmaceutical product presentations under the "ParMed" label as well as private labels in the U.S. ParMed, located in Niagara Falls, New York, had a telemarketing force that would telephone independent pharmacies and speak directly to the pharmacist concerning its products for sale, unlike Barre-National, NMC and Able who sold to large chain companies. After the restructuring, ParMed's operations remained the same. ParMed would inform the independent pharmacies where they could obtain the products discussed. But ParMed neither took orders nor filled orders. Barre-National compensated ParMed approximately $200,000.00 for this advertising function; however, such compensation was insufficient for ParMed to actually recognize a profit element.

34. The Division provided the testimony and opinion of its expert witness, Dr. Alan Shapiro, the Ivadelle and Theodore Johnson Professor of Banking and Finance and past chairman of the Department of Finance and Business Economics, Marshall School of Business, University of Southern California. Dr. Shapiro was offered as an expert in economics, transfer pricing, corporate finance, the valuation of intangibles and the flow of values in the member corporations of an affiliated or combined group. The focus of his report, entitled *Economic Analysis of Apportionment Issues Involving Alpharma, Inc.'s Combined Tax Reports in New*

York State for 1993-1995, concerns whether it is justifiable from an economic perspective to exclude from the numerator of the receipts factor component sales of tangible property shipped into New York made by operating entities of a firm, where these operating entities are not subject to tax in New York. Dr. Shapiro's report highlighted key intangibles that enabled Alpharma to develop, manufacture and profitably market its products: its regulatory skills, product and process technology expertise, marketing skills, organizational capabilities and financial resources. He noted that Alpharma also takes advantage of synergies in marketing, research and development, process technology, management, production, and logistics that cut across the entities comprising the Alpharma Group. For example, the ability to comply with regulatory standards, is a valuable skill that takes years of experience for a company or group to develop and it was Dr. Shapiro's conclusion that petitioner has evinced such accomplishment in ample measure. Along with the experience, petitioner has acquired and dedicated significant expenditures to this critical area, and by doing so, has created a natural barrier to competition with Alpharma Group's products, thereby having a positive effect on the group's sales. Each of the intangibles and synergies referred to in his report are similarly significantly detailed. Dr. Shapiro concludes that the Alpharma Group realizes significant flows of value and synergies between its members from the intangible assets and commonalities that are shared by the members of the Group. The expert notes that petitioner has argued that the distortions associated with these synergies and flows of value can only be cured by combining the incomes of both taxpayer and nontaxpayer members of the Alpharma Group, while excluding the sales to these nontaxpayer companies from the numerator of the receipts component of the apportionment factor. Given the fact that most, if not all, of the intangible assets and synergies benefit both the income and the sales of its member entities, he concludes that such an approach

would lead to distortion that would not exist if the sales of the nontaxpayer members were included in the receipts factor.

35. Petitioner introduced the testimony of Dr. Robert Cline, currently the National Director of State and Local Tax Policy Economics for Ernst & Young in Washington, D.C. He was accepted as an expert in State tax policy and in the area of corporate tax apportionment. He was requested to comment on the economic effect of the New York business allocation percentage including the sales of a company that is not a taxpayer. His testimony provided examples which he specifically prefaced with the statement that "it is not intended to be [sic] example that's tied directly to the taxpayers in this discussion. . . ." Dr. Cline's conclusion that "from an economic perspective, New York's approach [to taxation] is contributing a much higher share of net income to New York than is realistically related to the level of economic activity," though in response to questions asked of him, was made in a very general context without any reference to the facts in issue or petitioner's unitary group. A later clarification indicated that Dr. Cline believes that "absent legal constraint that we briefly discussed [Public Law 86-272], it does make economic sense to consider payroll, property and sales as factors that get you at the location underlying economic activity and it is a reasonable approach from an economic perspective." There was no written report of this expert submitted into evidence.

36. The second expert witness presented by petitioner was Professor Richard Pomp, who is a law professor at Connecticut Law School, and adjunct professor of law at both Harvard and Columbia Law Schools, instructing in the areas of state and local taxation, Federal personal and corporate taxation, and international taxation. He was admitted to testify as an expert in tax policy and federal law. When questioned in a general sense whether, from a tax policy standpoint, New York is doing here [imposing tax] indirectly what it cannot do directly,

Professor Pomp responded in a general statement without reference to the specific facts of this case, and referenced the recent U.S. Supreme Court case of ***Hunt-Wesson v. Franchise Tax Board*** (528 US 458, 145 L Ed 2d 974). Professor Pomp supports the notion of respecting the separate existence of corporations when considering whether a nontaxpayer's receipts should be included in a New York distorted combined return. He considers California a leader in the combined reporting area and related issues. There was no written report of this expert submitted into evidence.

37. In 1993, Able had $2,224,373.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1993, Barre-National had $20,753,259.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. The 1993 Alpharma Group's Article 9-A Tax return reflected these receipts as attributable to New York for purposes of computing the 1993 Alpharma Group's receipts factor.

The portion of the Article 9-A Tax that the 1993 Alpharma Group paid that is attributable to the inclusion of sales by Able and Barre-National in the numerator of its receipts factor for the year 1993 is $66,489.00. The Notice issued by the Division asserts that the 1993 Alpharma Group owes an additional $15,200.00 in Article 9-A tax for 1993 over what it has already paid with respect to 1993. After taking into account the uncontested adjustments made by the Division, if the receipts identified in the paragraph above are not included in the numerator of that year's receipts factor of the business allocation percentage, the refund that would be due the 1993 Alpharma Group is $51,289.00 (comprised of $47,398.00 of franchise tax and $3,891.00 of MTA surcharge).

38. In 1994, Able had $1,615,848.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1994, Barre-National had $12,390,642.00 in

receipts attributable to sales of tangible personal property shipped to locations in New York. In 1994, Wade Jones had $61,104.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. The 1994 Alpharma Group's Article 9-A tax return reflected these receipts as attributable to New York for purposes of computing the 1994 Alpharma Group's receipts factor.

The portion of the Article 9-A Tax that the 1994 Alpharma Group paid that is attributable to the inclusion of sales by Able, Barre-National and Wade Jones in the numerator of its receipts factor for the 1994 tax year is $42,646.00. The Notice issued by the Division asserts that the Alpharma Group owes an additional $25,417.00 in Article 9-A Tax for 1994 over what it has already paid with respect to 1994. After taking into account the uncontested adjustments made by the Division, if the receipts identified in the paragraph above are not included in the numerator of that year's receipts factor of the business allocation percentage, the refund that would be due the 1994 Alpharma Group is $17,229.00 (comprised of $15,892.00 of franchise tax and $1,337.00 of MTA surcharge).

39. In 1995, Alpharma had $6,288,553.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1995, Barre-National had $20,136,974.00 in receipts attributable to sales of tangible personal property shipped to locations in New York.

The 1995 Alpharma Group's article 9-A Tax return did not reflect any of the receipts noted in the paragraph above as attributable to New York for purposes of computing the 1995 Alpharma Group's receipts factor. The portion of the tax liability assessed on the subject Notice that is attributable to the inclusion of the subject sales noted above for 1995 in the numerator of the receipts factor is $82,954.00 ($76,600.00 of franchise tax and $6,354.00 of MTA surcharge).

40. The 1995 Alpharma Group correctly excluded receipts from sales of tangible personal property made by ParMed, where shipments were made to points without New York State, in determining the numerator of its receipts factor for purposes of computing its business allocation percentage. The Division mistakenly included these receipts in determining the numerator of the 1995 Alpharma Group receipts factor for purposes of the Notice. The amount of receipts erroneously included in the numerator of the receipts factor with respect to ParMed for 1995 is $16,853,565.00.

41. If it is determined that the receipts of Alpharma and Barre-National should be included in the numerator of the 1995 Alpharma Group's receipts factor of the business allocation percentage, the 1995 Alpharma Group will owe an additional $87,385.00 (comprised of $80,692.00 of franchise tax and $6,693.00 of MTA surcharge). If it is determined that receipts of Alpharma and Barre-National should not be included in the numerator of the 1995 Alpharma Group's receipts factor of the business allocation percentage, the 1995 Alpharma Group will owe an additional $4,430.00 (comprised of $4,091.00 of franchise tax and $339.00 of MTA surcharge).

SUMMARY OF THE PARTIES' POSITIONS

42. Petitioner maintains that the United States Constitution and Public Law 86-272 restrict New York's ability to tax certain corporations. Petitioner and the Division agree as to which corporations were nontaxpayers for the years in issue. However, the parties do not agree as to whether a particular corporation had no contacts with New York and was therefore constitutionally protected from taxation by New York under the Commerce Clause, or whether the only contacts such corporations had with New York were activities that provided them

protection from taxation pursuant to Public Law 86-272. Petitioner posits that the Division does not have the jurisdiction to tax the Alpharma Group nontaxpayers.

43. In support of its position, petitioner urges respect for the separate status of the corporate entities. It asserts that recognizing separate status is consistent with the inclusion of such corporation's net income in the net income of the combined group, since it is well accepted that inclusion of a nontaxpayer's net income can be used to determine the combined net income of a unitary business when it is difficult to determine the net income attributable to each member of a unitary business by means of a separate accounting. However, petitioner asserts, in determining the net income of the combined group properly apportionable to New York, the receipts of the nontaxpayers should not be included in the numerator of the group's receipts factor. Petitioner notes that combined reporting, as an accounting methodology, does not pierce the corporate veil and ignore the separate existence of the corporations. Petitioner asserts that combined reporting and the unitary business principle have only been applied, and should only be applied herein, to combine the *net income* of the unitary group, not the numerators of the factors comprising the apportionment formula. Although combining the net income of the nontaxpayers may be required as an initial step in fair apportionment, petitioner urges that inclusion of the inbound sales of nontaxpayers in the numerator of the combined group's receipts factor is not required, because there is no reason to ignore the separate status of the nontaxpayer corporations with respect to the corporation's factors. Further, petitioner argues that the Division cannot impose taxes indirectly on that which it could not impose directly. In conclusion, petitioner maintains that inclusion of such receipts would, in effect, impermissibly disregard the separate existence of corporations that were members of a unitary group, and the

prohibitions of the Commerce Clause and Public Law 86-272, and thus result in taxation of corporations that are not within New York's jurisdictional scope.

Petitioner argues that its position is supported by and consistent with the Administrative Law Judge determination in ***Silver King Broadcasting of N.J., Inc.*** (Division of Tax Appeals, August 10, 1995) on the same issue concerning the receipts factor.

Petitioner finally argues that the Division cannot claim that inclusion of the nontaxpayer corporate receipts is necessary due to the distortion requirement, because the distortion requirement is satisfied by including the net incomes of the group in the apportionment scheme.

44. The Division takes the position that the subject sales were properly included in the numerators of petitioner's receipts factors used in the apportionment formula for combined reporting purposes. In support of its position, the Division maintains that excluding the subject sales from the numerator of the receipts factor while including the income generated by those sales in the reports' combined entire net incomes, defeats the reason for the combined returns, i.e., to avoid distortion by fairly representing the taxpayer members' income, activities, capital and business in New York. The Division asserts that the distortion would manifest itself in the combined group's markets and customer locations being unfairly represented.

Furthermore, the Division argues that 20 NYCRR 4-4.7 requires that a combined group's receipts factor must treat the combined group as a single corporation, meeting the intent of Tax Law § 211(4) of determining the proper tax liability in the State for the combined group.

The Division additionally argues that by requiring the subject sales in the numerators as discussed, the Division is not asserting its taxing jurisdiction over the nontaxpayer members of petitioner's combined groups. The Division claims this to be the case since the purpose and effect of New York's apportionment formula is not to exert jurisdiction over the subject sales, or

the income they produce, but is rather only an attempt to measure the unitary group's level of activity in the State in order to properly reflect the tax liability of the taxpayer members of the combined group.

The Division maintains that a state's jurisdiction to tax begins with allocated income, and an inclusion before that point in any part of the apportionment formula is not taxation, citing ***Shell Oil Company v. Iowa Department of Revenue*** (488 US 19, 102 L Ed 2d 186).

45. The Division asserts that petitioner has not met its burden of proof concerning the Commerce Clause restriction on New York's ability to include the sales in issue in the numerators of the receipts factors, inasmuch as petitioner has not asserted, or established, that the apportionment formula applied to petitioner is unfair.

46. The Division maintains that petitioner has not met its burden of proving that the subject sales are protected from inclusion by Public Law 86-272. In this regard, the Division argues that the history of Public Law 86-272 does not support exclusion of such sales; petitioner's experts did not lend support to petitioner's position; ***Matter of Silver King Broadcasting of N.J.*** (Division of Tax Appeals, August 10, 1995) is not precedential; and ***Hunt Wesson v. Franchise Tax Board*** (528 US 458, 145 L Ed 2d 974) does not support petitioner's position that the Division is indirectly taxing the nontaxpayer members of its combined groups.

CONCLUSIONS OF LAW

A. Petitioner attempts to isolate the issue in this case as a jurisdictional one, a matter of law, and places less focus on the facts which surround the Alpharma Group's unitary business relationship. The Division focuses on the substantive apportionment scheme applied to the unitary business relationship and the distortion which results by the suggested noninclusion of the nontaxpayer receipts in issue, all of which is discussed in the context of a fact-driven query.

What we have is essentially both: a jurisdictional question concerning constitutional limitations on the State's power to tax which arises in the context of a unitary business relationship of a multijurisdictional (interstate and international) corporate organization, and a substantive apportionment question. By including receipts of nontaxpayers in the combined reports' receipts factors, New York is imposing jurisdiction over the subject sales, even if the purpose for doing so is to attribute some measure of the unitary group's activity in the State to such corporation. The question remains, however, whether such jurisdiction is prohibited due to Federal constraints, whether constitutional or congressional. Although jurisdiction must be addressed first, it cannot be separated from the environment in which the question arises, i.e., by reference to the facts which contribute to a functionally integrated group and unitary business relationship among the corporations. I do not agree with petitioner's position that facts which establish combination and the unitary relationship of the Alpharma Group are irrelevant with respect to whether the nontaxpayer receipts should be included in the numerator of the receipts factor. It is by reference to such facts that I believe a response to the jurisdictional issue is found.

In the broad picture, this matter involves Federal limitations on State taxation. Such limitations take two primary forms: constitutional constraints and statutory constraints. The constitutional concerns pertinent herein arise from the Due Process and Commerce Clauses of the United States Constitution. The Federal statutory constraint on taxation which is applicable in this matter is Public Law 86-272 (15 USC § 381) enacted in 1959.

For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a "minimal connection" between the interstate activities and the taxing State and a rational relationship between the income attributed to the State and the intrastate values of the enterprise (***Mobil Oil Corporation v. Vermont***, 445

US 425, 63 L Ed 2d 510, 520). The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State .(***Id***.)

The Commerce Clause permits a state to constitutionally tax a corporation that engages solely in interstate commerce, only if there is a sufficient nexus between the state and the taxpayer, the tax does not discriminate against interstate commerce, the tax is fairly apportioned, and the tax is fairly related to benefits provided by the state to the taxpayer (***Complete Auto Transit, Inc. v. Brady***, 430 US 274, 51 L Ed 2d 326).

Under the Supremacy Clause of the United States Constitution, congressional power that is properly exercised, such as in the enactment of the Federal legislation referred to as Public Law 86-272, preempts any conflicting state legislation. Therefore, as applied to this matter, state income taxes imposed by New York on nontaxpayer corporations whose in-state activities do not exceed the minimum activities protected by Public Law 86-272 are unconstitutional. Public Law 86-272 stands for the proposition that states may not impose tax measured by income on business if the business's only activity (presence) in the state is the solicitation of orders for sales of tangible personal property if such orders are accepted outside the state and are filled by shipments into the state (***Gillette Co. v. State Tax Commn***, 56 AD2d 475, 393 NYS2d 186, ***affd*** 45 NY2d 846, 410 NYS2d 65). The impetus behind enactment of Public Law 86-272 was the U.S. Supreme Court's decision in ***Northwestern States Portland Cement Co. v. Minnesota*** (358 US 450, 3 L Ed 2d 421). The Court held that the net income from the interstate operations of a nondomiciliary (Iowa) corporation may be subjected to (Minnesota) State taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same. The Court upheld the constitutionality of a Minnesota tax on an Iowa cement manufacturer which maintained a sales office and staff in

Minnesota to solicit orders, subject to acceptance and processing in Iowa, and encouraged cement users there to order Northwestern cement when ordering from local wholesalers. Congress quickly responded to the concerns of the business community that "mere solicitation" would subject a business to state taxation, since ***Northwestern*** did not adequately specify what local activities would be enough to create a sufficient nexus for the exercise of the state's power to tax. The question raised was what activities would sufficiently form a connection with the state to support the imposition of a tax on net income from interstate operations properly apportioned to the state.

Although the standards of Due Process, the Commerce Clause and Public Law 86-272 differ somewhat, the common thread as related to this matter is the question of jurisdictional nexus. The fact that petitioner is part of a unitary group does not, in and of itself, increase its presence in New York in order to meet constitutional criteria for nexus. The mere presence of an in-state affiliate of a unitary group does not confer nexus on a non-phantom out-of-state affiliate of the same group. In the unitary taxation scheme, the foreign corporations's income and factors may be included in determining the tax liability of the in-state affiliate. However, without nexus, the foreign corporation does not become subject to the taxing jurisdiction (***MCI Int'l Telecommunications Corp. v. Comptroller of the Treasury***, Maryland Tax Court, April 26, 1999 [1999WL 322702]; ***see***, Hellerstein & Hellerstein, State Taxation, ¶ 6.13[1][3rd ed]). As the Supreme Court stated in ***Mobil Oil Corporation v. Commissioner of Taxation of Vermont*** (445 US 425, 63 L Ed 2d 510, 522), "[T]he linchpin of apportionability in the field of state income taxation is the unitary business principle." A review of the United States Supreme Court decisions in this area, from ***Complete Auto Transit, Inc.***, (***supra***) through ***Mobil Oil Corp***. (***supra***), ***Exxon Corporation v. Wisconsin Department of Revenue*** (447 US 207, 65 L Ed 2d

66), and ***Container Corporation of America v. Franchise Tax Board*** (463 US 159, 77 L Ed 2d 545), 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). The Hellerstein treatise (***supra*** at ¶ 8.07) provides the following guidance concerning the constitutional underpinnings of the unitary business principle:

> The constitutional doctrine that a state may not tax a corporation's property, income, or gross receipts unless there is 'some definite link, some minimum connection' (***Miller Bros. V. Maryland***, 347 US 340, 344-345, 74 S. Ct. 535) between the state and the corporation's activities within the state derives from the virtually axiomatic proposition that the exercise of a state's tax power over a taxpayers's activities is justified by the 'protection, opportunities and benefits'(***Wisconsin v. J.C. Penney Co.***, 311 US 435, 444, 61 S. Ct. 246) the state confers upon those activities. If the state lacks a 'minimum connection' or 'definite link' with the taxpayer's activities, and thus with the property, income or gross receipts related to those activities, it has not 'given anything for which it can ask return.' (***Id***.)
>
> The bedrock constitutional principle that a state may not tax activities with which it lacks a concrete connection generally confines the exercise of a state's tax power to activities conducted within its borders. It is often difficult, however, if not impossible, for a state to determine with precision the value of property or the amount of income attributable to a multistate or multinational corporation's in-state activities (***see***, ***e.g., Container Corp. of Am. v. Franchise Tax Bd.***, 463 US 159, 164, 103 S. Ct. 2933; ***Butler Bros. v. McColgan***, 315 US 501, 507-509, 62 S. Ct. 701; ***Underwood Typewriter Co. v. Chamberlain***, 254 US 113, 120-121, 41 S. Ct. 45). Recognizing these difficulties, the Court has long permitted the states to determine the property, income or receipts of a multijurisdictional corporation attributable to a state by apportionment. Under the apportionment method, the state considers the property, income, or receipts related to all of the corporation's activities--out-of-state as well as in-state–and then apportions a share of such property, income, or receipts to the taxing state by means of a formula that compares the taxpayer's in-state activities to all of its activities. While thus permitting the states to include property, income, or receipts from a corporation's out-of-state activities in the corporation's apportionable tax base, the Court has not thereby abandoned the requirement that there must be a 'definite link' or 'minimum connection' between the state and the corporation's in-state activities or has countenanced the taxation of extraterritorial income (***citing Shell Oil Co. v.***

Iowa Dep't of Revenue, 488 US 19, 30-31, 109 S. Ct. 278). Rather the Court has insisted on such a link by reference to the unitary business principle.

> Under the unitary business principle, if a taxpayer is carrying on a single 'unitary' business within and without the state, the state has the requisite connection to the out-of-state activities of the business to justify inclusion in the taxpayer's apportionable tax base of all of the property, income, or receipts attributable to the combined effect of the out-of-state and in-state activities. By the same token, if the taxpayer's activities carried on within the state are not unitary with its activities carried on elsewhere, the state is constitutionally constrained from including the property, income, or receipts arising from those out-of-state activities in the taxpayer's apportionable tax base.

One of petitioners' experts, Professor Richard Pomp referred to the State of California as the "intellectual leader of combined reporting." A review of key California decisions reveals that the courts there too have struggled with the issue of when a taxpayer makes sales in a state in which it is not taxable but in which other members of the taxpayer's unitary group are taxable, whether those sales should be attributed to the destination state in determining the unitary group's sales factor. In 1966, the California State Board of Equalization ("SBE") decided ***Appeal of Joyce*** (Cal State Bd Of Equaliz, Nov. 23, 1966 [Dkt. No. 66-SBE-070]). ***Joyce*** involved an Ohio corporation and its California subsidiary, both of which sold shoes in California. Only the subsidiary was subject to taxation in California. California has a three-factor (property, payroll and receipts) statutory apportionment formula where each of three fractions has a numerator representing the amount attributable to California and a denominator representing the worldwide amount, a statutory scheme derived from the Uniform Division of Income for Tax Purposes Act ("UDITPA"), adopted by many states. The SBE concluded that the California-destined sales by the parent company, which were not subject to tax in California, could not be included in the allocation formula for purposes of calculating the sales factor, even though another member of the group was taxable in California. The SBE determined that Public Law 86-272 prevented the state from including receipts from sales of goods shipped to

California customers from a member of a unitary group which conducted business in the state, but itself was not taxable in the state, where the individual members's sole contact in California was sales representatives who solicited, but could not accept orders in the state. Twenty-four years later, the SBE overruled ***Joyce*** in ***Appeal of Finnigan*** (Ca. State Bd Of Equaliz, Aug. 25, 1988 [Dkt. No. 88-SBE-022]) as "contravening fundamental unitary theory" for two reasons: first, by forbidding the assignment of sales to the state of destination in situations where at least one member of the unitary group is taxable in that state, but the actual seller is not, the ***Joyce*** rule defeats the basic purposes of the sales factor, which is to reflect the market for the unitary business's goods and services. Second, by focusing on the state's jurisdiction to tax the seller as a separate corporate entity, the rule elevates form over substance by yielding a different apportionment result depending solely on whether the unitary business is conducted by several corporations or only by one. The SBE next faced ***Appeal of NutraSweet Company*** (Cal Tax Rptr ¶ 402-524, Oct. 29, 1992), which contained facts similar to ***Joyce***. In ***NutraSweet***, sales in California by a Puerto Rico subsidiary of a unitary group were attributed to California for purposes of the sales factor because a part of the group was taxable in California, even though the actual seller was not. The ***NutraSweet*** decision applied the rule in ***Finnigan*** to tax years 1974 through 1977, retroactively, and sustained the inclusion of the California destined sales by a California nontaxpayer in the California sales factor numerator of the unitary group of corporations. The next case was ***Brown Group Retail, Inc. v. Franchise Tax Bd.*** (Cal Super Ct, Los Angeles Cty., Oct. 8, 1993, Dkt. No. C714010, ***revd on other grounds***, 44 Cal App 4th 823). Brown Group Retail, Inc. ("Brown"), a wholly-owned subsidiary of Brown Group Inc. ("BGI"), was a successor by merger to Wetherby-Kayser Shoe Company, a Missouri corporation, with its principal place of business in Missouri. Brown owned no real or tangible personal property in California except automobiles, which it leased for exclusive use by its sales

representatives, and maintained no office, warehouse, store or factory in California. Brown manufactured and distributed shoes and other footwear products to thousands of independent and unrelated entities nationwide. No sales of products were made in California, but instead orders were sent from customers in California to the home office and the goods would be sent to customers by carriers from outside California. The focus of the matter was Brown's Independent Retail Distributor Division ("IRD"), consisting of two representatives (as opposed to its other 14 sales representatives), whose actions were deemed by the trial court to consist of mere solicitation, which resulted in BGI's being immune from the imposition of California franchise taxes pursuant to Public Law 86-272. The trial court also rejected the Franchise Board's claim that the payroll attributed to California employees and the sales made in California by Brown should have been included in calculating the amount of taxes owed by the unitary group of BGI. The Franchise Board appealed and the Superior Court reversed, based on facts not detailed herein, that the business of the IRD employees was not merely to solicit sales for Brown, but also to assist in the development of new business opportunities for retailers and aid existing retailers in expanding their businesses, with the hope that Brown would benefit by means of increased sales (***Id.*** at 828). The Superior Court did not rule on the issue of whether the sales receipts should be included in the numerator of the receipts factor, and because of the trial court's reversal, its decision on the ***Joyce/Finnigan*** issue has been deprived of precedential significance (***see,*** Hellerstein & Hellerstein, State Taxation, ¶ 9.18[1][a][3rd ed]).

The current state of affairs in California seems to be represented by ***Citicorp North America, Inc. v. Franchise Tax Board*** (83 Cal App. 4th 1403, ***cert denied*** 533 US 963, 150 L Ed 2d 776), decided October 2, 2000. Citicorp, is a Delaware corporation with its principal place of business in New York and, along with its affiliate corporations, is part of a nationwide financial services organization. Citicorp directly and indirectly owns several hundred foreign and

domestic corporations, 88 of which were California taxpayers, that offer lending, investment management and other traditional financial and banking services. For tax years 1985 through 1988, Citicorp and its affiliates filed separate company franchise tax returns in California. In 1992 and 1993 they sought to amend the returns, requesting refunds for the challenged years, by arguing that Citicorp was conducting a worldwide unitary business and that the combined franchise tax must be computed on a unitary basis. Citibank South Dakota, an affiliate corporation that handles VISA and MasterCard credit card business, was a member of the unitary group for the year in question. The South Dakota affiliate had no physical presence in California, its only office was in South Dakota, and it was not subject to California's corporate franchise tax during the years in issue. Citibank South Dakota had credit card customers in California and in calculating its California sales, Citicorp excluded California sales by Citibank South Dakota in accordance with ***Joyce***. The Franchise Tax Board audited the amended returns and recalculated the sales pursuant to the rule in ***Finnigan***. Citicorp argued that including the property and sales of the South Dakota affiliate is inconsistent with the Revenue Taxation Code and the unitary method of taxation in that it ignores separate business identities. Citicorp believed that the result in ***Finnigan*** twists the unitary method and allows California to tax the income of a nontaxpaying entity. The question presented was whether the application of ***Finnigan*** was appropriate and constitutional. The court stated that:

> [B]y considering the California income of Citibank (South Dakota), the FTB is not taxing, but is apportioning income attributable to California. Taxes are actually imposed only on the corporations that are subject to California's taxing jurisdiction. Our Supreme Court has approved apportionment formulas as an appropriate method of determining the California income of a unitary group of corporations. The United States Supreme Court held that computing income of a unitary business that is allocable to one state by use of a reasonable formula does not result in an impermissible tax on extraterritorial values (***supra*** at 1415). . . . Finnigan's methodology is consistent with accepted principles of taxation of a unitary business. . . . The rule applied here results in recognition that the unitary group benefited [sic] from sales in California (***supra*** at 1417).

* * *

> The Supreme Court has stated that the Constitution does not invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing [s]tate. An apportionment formula will only be struck down where the challenger proves 'by clear and cogent evidence that the income attributed to the state is in fact 'out of all appropriate proportions to the business transacted. . . in that state' or has 'led to grossly distorted results.' Citicorp has not sustained this burden.
>
> Although constitutional limits on a state's ability to tax interstate businesses exist, they allow the states 'wide latitude' to choose a method of apportionment. The main restrictions on a state's ability to tax are: (1) a minimal connection between the activities of the business and the taxing state; and (2) the 'income attributable to the State for tax purposes must be rationally related to 'values connected with the taxing State.' Thus, when a state's method of apportionment represents a 'rough approximation of a corporations's income that is reasonable related to the activities conducted within the taxing State, 'no states's method appears to reach only the profits earned in the state, and the taxpayer failed to show that 'the method of apportionment. . . was inherently arbitrary, or that its application . . . produced an unreasonable result' the state's action is within constitutional bounds (citations omitted)(83 Cal App 4th 1403, 1426).

The court concluded that the ***Finnegan/NutraSweet*** apportionment methodology was legal, could be applied retroactively and did not violate the Federal Commerce Clause or the Federal and State Due Process and Equal Protection Clauses. Acknowledging the fact that New York is not bound by the decisions of another state, it is nonetheless useful to look to other jurisdictions for interpretive guidance.

B. This case centers around the benefits and burdens of a unitary business and begins with petitioner's decision to file corporate tax returns in New York on a combined reporting basis. Petitioner's request for permission to file on a combined basis, though made in 1992, the year before the tax years in issue, has great significance in this matter. It is the facts which contribute to a determination that a unitary operation exists which precipitate a corporate connection that brings the nontaxpayers before this New York forum. The parties have agreed that the request for permission to file corporate tax returns for the years in issue on a combined

basis was properly granted. In order to receive such permission in New York, a group of taxpayers must establish that they meet the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State, such that it would be "extremely difficult to determine the accurate computation of income on a separate company basis"). Finding of Fact "2" sets forth the information initially provided by petitioner for the Division to consider the propriety of the request to file a combined report a year prior to the first tax year in issue. The description of the corporate functions and operations clearly establish functional integration, centralization of key management and economies of scale (***see, Container Corp. of Am v. Franchise Tax Bd., supra***). Based upon the information provided, there has been no challenge, then or now, to the unitary relationship, and the Division readily granted tentative permission for petitioner to file on a combined basis. Petitioner did not at any time assert that the reasons for filing a combined report as set forth in the January 1992 correspondence had changed. Taking into consideration that the Alpharma Group continued to grow (***see,*** Finding of Fact "21"), strengthen its operations and streamline into specialty divisions, the inquiry must focus on the relationships the corporations had to each other and to New York, not merely what each individual corporation's relationship was to New York without reference to the unitary group.

The corporations subject to tax as New York taxpayers in 1993 and 1994 were ParMed, NMC and Alpharma, and in 1995 were ParMed and NMC. For tax year 1993, petitioner asserts that of the five companies not subject to tax in New York (***see,*** Finding of Fact "7"), Specialty, NW and Reilly, had no taxable connection to New York at all. It is asserted that the remaining two, Barre-National and Able were not taxable because their activities were limited to those protected by Public Law 86-272, i.e., "mere solicitation." The tax assessed for 1993, relates to

the inclusion of receipts of Barre-National and Able (arising from sales whose destination was New York) in the numerator of the receipts factor for the 1993 New York apportionment formula (***see,*** Finding of Fact "37").

For 1994, petitioner asserts that of the six companies not subject to tax in New York (***see***, Finding of Fact "10"), Specialty, NW and Reilly, had no taxable connection to New York at all. It is asserted that the remaining three, Barre-National, Able and Wade Jones were not taxable because their activities were limited to those protected by Public Law 86-272. The tax assessed for 1994, relates to the inclusion of receipts of Barre-National, Able and Wade Jones (arising from sales whose destination was New York) in the numerator of the receipts factor for the 1994 New York apportionment formula (***see***, Finding of Fact "38").

For 1995, petitioner asserts that of the eight companies not subject to tax in New York (***see***, Finding of Fact "14"), Specialty, NW, Reilly, Wade Jones, US and Able had no taxable connection to New York at all. It is asserted that the remaining two, Barre-National and Alpharma were not taxable because their activities were limited to those protected by Public Law 86-272. The tax assessed for 1995 relates to the inclusion of receipts of Barre-National and Alpharma (arising from sales whose destination was New York) in the numerator of the receipts factor for the 1995 New York apportionment formula (***see***, Finding of Fact "39").

In order for petitioner's argument to prevail, I would have to find that for 1993 Barre-National and Able's business activities within New York consisted *only* of the solicitation of orders in New York for sales of tangible personal property, where the orders were sent outside the State for approval or rejection, and if approved, were filled by shipment or delivery from a point outside the State (15 USC § 381), and nothing further. Likewise for Barre-National, Able and Wade Jones in 1994, and Alpharma and Barre-National for 1995.

Barre-National and Able, two nontaxpayers, represented two of the four USPG/USPD companies. The others were NMC and ParMed, New York taxpayers. This group of companies (later a division of petitioner) have comprised the U.S. portion of the Human Pharmaceuticals Division for the entire audit period. They experienced intercompany sales, an intercompany lease, common management under one president (George Barrett) and management team, a common connection to petitioner for a myriad of management functions, including financial advice and assistance, budget approvals, pension plan administration, debt guarantees, and regulatory support and funding (***see***, Finding of Facts "28 through 33"). Despite the fact that their operations may be somewhat independent, to the extent Animal Health did not overlap with Human Pharmaceuticals in many areas, such as customer base or regulatory concerns, as part of a unitary business these companies relied upon each other for the varying strengths each had to offer. Prime examples include the management and support provided by Alpharma, without compensation, to the subsidiaries, as well as ParMed's sophisticated telemarketing functions sought by each member of the USPD for which it was insufficiently compensated to reflect a profit for its efforts on behalf of the USPD members. To characterize Barre-National and Able as two non-New York taxpayers who merely solicited sales in the State would be a gross understatement of the relationship that the companies had with members of their own group, NMC and ParMed (New York taxpayers), petitioner (their parent company), other subsidiaries and the State of New York for all the years in issue. Certainly, there would be a failure to properly reflect the in-state business activities conducted by Barre-National and Able without the inclusion of the receipts in the numerator, which is the purpose for such inclusion.

The Hellerstein treatise (***supra*** at ¶ 8.11[1]) reports that:

> State courts have rejected challenges to the constitutionality of combined apportionment by taxpayers who have argued that combined apportionment effectively taxes corporations without nexus with the state or that it taxes

> extraterritorial income. Such courts have taken the position that the combined method is merely designed to determine the amount of the income of the in-state taxpayer properly attributable to the state. In support of this position, there is ample Supreme Court authority holding that states may look to extraterritorial values for purposes of determining the values that are properly taxable by the state. Indeed, the U.S. Supreme Court in ***Container*** laid to rest any doubt as to the constitutionality, under the Federal Constitution, of applying formulary apportionment to the tax base of a unitary group of corporations, some of whose members were not taxable by the state, as a means of ascertaining the income of the corporations that were taxable by the state. As the Court subsequently declared in ***Barclays Bank PLC v. Franchise Tax Board*** (512 U.S. 298, 312 n.10), [T]he theory underlying unitary taxation is that 'certain intangible 'flows of value' within the unitary group serve to link the various members together as if they were essentially a single entity.' Formulary apportionment of the income of a multijurisdictional (but unitary) business enterprise, if fairly done, taxes only the 'income generated within a State.'

If petitioner herein demonstrated that the property, payroll or receipts assigned to the State by formula apportionment bore no relationship to petitioner's local presence or activities, the Due Process and Commerce Clauses, as well as Public Law 86-272, would bar the State from taxing such items assigned to the State by such formula. This is not only a heavy burden for petitioner to carry, but an argument that has not been asserted in this matter. Petitioner actually demonstrated just the opposite. Accordingly, for tax years 1993 and 1994, Barre-National's and Able's receipts, and Barre-National's receipts for 1995, are not entitled to Commerce Clause or Public Law 86-272 protection from New York State taxation inasmuch as the companies' connection or nexus with New York, vis-a-vis their unitary relationship with petitioner and the other USPD companies, far exceeded the minimum connection required between their business activities and the State.

Alpharma and the Animal Health segment were the backbone of this unitary group (***see***, Findings of Fact "16 through 27"), and it was from the vantage point of the parent's position that the group made its critical decisions. The structure of the Alpharma Group did not remain exactly as it had been in 1992 when request for permission to file on a combined basis was

postured. However, it is clear that the functions performed by Alpharma's "corporate division" continued throughout the audit period to be management functions of petitioner. The operational changes within each business segment primarily related to their growth and consolidation of resources. Petitioner's witness and treasurer, Albert Marchio, attempted to paint a picture of petitioner's role with regard to the subsidiary corporations as quite passive, unintrusive and virtually uninvolved. The vast amount of information provided by petitioner's Annual Reports and SEC Form 10-K filings, however, provided compelling evidence to the contrary (***see,*** Finding of Facts "18 through 22 and 24 through 33"). In his testimony, Mr. Marchio characterized the facts in the January 1992 correspondence in which petitioner requested permission to file on a combined basis as "overstated" by Robert Pudlak, a man whose position at that time was vice president of finance and chief financial officer, and who had been a key player with the company since 1985, or perhaps longer. Certainly he was in a position to fully comprehend the corporate relationships. Although I would not characterize Mr. Marchio's testimony as untruthful, clearly it appeared guarded and incomplete, the result of which was misleading.

It was petitioner's board of directors that established the office of the chief executive to add strength to its future corporate strategy and work with the senior management of each of the specialty businesses of both Animal Health and Human Pharmaceuticals domestically and internationally. Petitioner made decisions about mergers and acquisitions affecting its divisions, such as Able for the Human Pharmaceuticals group and Wade Jones for the Animal Health group. Wade Jones was acquired by petitioner in July 1994 and became a major player in petitioner's Animal Health Division. Animal Health segment revenues increased in 1995 primarily due to the acquisition of Wade Jones. Petitioner performed a myriad of services for all the subsidiaries with regard to finances, insurance, general management, budgets, legal

services, risk management, pension plans, parent company debt guarantees, the negotiation of credit, and regulatory compliance matters. The subsidiaries were not charged fees for such services. The integration of the businesses which comprised the unitary group are inextricably intertwined, with Alpharma at the lead. Clearly the connection petitioner and Wade Jones had with New York in the context of the unitary group provided the requisite jurisdictional nexus. Accordingly, for tax years 1994 and 1995, the receipts of Wade Jones and Alpharma, respectively, are not entitled to Commerce Clause or Public Law 86-272 protection from New York State taxation inasmuch as the companies' connection or nexus with New York, vis-a-vis their unitary relationship with New York taxpayer companies and each other, far exceeded the minimum connection required between their business activities and the State.

The unitary business provides a great deal of benefit to a multijurisdictional group of corporations. With this business form there are also burdens. Perhaps it can be argued that the inclusion of the nontaxpayer receipts issue is one of them. That may be so, but it does not make such inclusion unconstitutional or without a rational basis under the facts of this case. Accordingly, the receipts in issue will be included in the numerator of the receipts factor of the apportionment formula for all the tax years in question.

C. New York State tax regulation at 20 NYCRR 4-4.7 provides, in pertinent part, that the receipts factor on a combined report is computed as though the corporations included in the report were one corporation. This regulation is supportive of the notion that the separate status of corporations is ignored to the extent of the inclusion of the receipts of all corporations who have established their unitary relationship and are reporting or seeking to report income on a combined basis.

D. The parties disagree as to the meaning of the Court's references to the Iowa apportionment formula and unitary business principles discussed in ***Shell Oil Company v. Iowa***

Department of Revenue (***supra***). Petitioner and the Division both believe ***Shell*** lends support to their positions. However, inasmuch as jurisdictional nexus, Public Law 86-272 and whether the sales in question should be included in the numerator of the receipts factor of the Iowa apportionment formula were not issues in ***Shell***, the case is not sufficiently similar to warrant a discussion of the isolated statements petitioner and the Division attempted to apply to this matter.

E. Regarding the Division's assertion that the subject receipts must be included in the numerator of the receipts factor in the apportionment formula, the Division's expert, Dr. Shapiro provided testimony and a detailed report highlighting the functional integration, common management and synergies among the members of the Alpharma Group (***see***, Finding of Fact "34"). I believe Dr. Shapiro's conclusion, that petitioner's approach to the receipts issue would result in distortion that would otherwise not exist, is on target. Having concluded that the facts which contribute to a finding that the business is a unitary one also provide the jurisdictional nexus, it is logical to find that distortion would exist if the apportionment formula is so altered, having no evidence that there is a lack of a rational relationship between the business activities of the nontaxpayers and the State, vis-a-vis the unitary business, or that the income attributed to the State is out of all appropriate proportion to the business transacted there (***see, Container Corp., supra***).

F. Petitioner points to the Administrative Law Judge's determination in ***Silver King Broadcasting of N. J., Inc.*** (***supra***) in support of its position that the receipts should not be included in the numerator of the receipts factor. As properly noted by the Division, inasmuch as determinations of Administrative Law Judges are not precedential of (20 NYCRR 3000.15[e][2]), the Administrative Law Judge's determination in ***Silver King Broadcasting of N.J.***, ***Inc.*** (***supra***) is not controlling.

G. Petitioner further argues that New York is imposing a tax indirectly when forbidden by the Constitution to do so directly, citing ***Hunt-Wesson, Inc. v. Franchise Tax Board*** (528 U.S. 458, 145 L Ed 2d 974). The Division asserts that ***Hunt-Wesson*** does not support petitioner's assertion that the Division is indirectly taxing the nontaxpayer members of its combined group. Petitioner in that case was a successor interest to a nondomiciliary business of California that incurred interest expense during the years in issue. California's unitary system of taxation authorized a deduction for interest expense, but only to the extent that the amount exceeded certain out-of-state income arising from the unrelated business activity of a discrete business enterprise, i.e., non-unitary income that the State could not otherwise tax. The Supreme Court reminds us that under its precedent (***citing Allied Signal***, 504 US at 772-773, 119 L Ed 2d 533), non-unitary income may not constitutionally be taxed by a State other than the corporation's domicile, unless there is some other connection between the taxing State and the income. California's rule measures the amount of additional unitary income that becomes subject to taxation (through reducing the deduction) by precisely the amount of nonunitary income that the taxpayer has received. It is for that reason that the Court found what California calls a "deduction limitation," in fact, an impermissible [unconstitutional] tax (***Hunt-Wesson v. Franchise Tax Board, supra*** at 981).

By definition, nonunitary income is that which bears no jurisdictional nexus or rational relationship to a given jurisdiction, in this case, to New York. Inasmuch as I have already discussed and determined the basis for connection between the nontaxpayer corporations of petitioner's unitary business (as opposed to a nonunitary discrete enterprise which did not exist in this case) and New York, ***Hunt Wesson*** does not support petitioner's position. Although one of petitioner's experts referenced Hunt-Wesson, I do not find his comments compelling. In fact, that portion of the testimony of petitioner's two experts which was not connected directly to the

facts at hand, or explained in a written report, is given little weight, inasmuch as its delivery was general and not directed to the factual context in which these corporations operated (***see***, Findings of Fact "35 and 36").

H. The petition of Alpharma, Inc. is hereby denied; the refunds described in Findings of Fact "37 and 38" are denied; and the Notice of Deficiency dated April 17, 2000, as adjusted and agreed and set forth in Findings of Fact "39", "40" and "41," is sustained.

DATED: Troy, New York
September 12, 2002

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE