STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

BOEHRINGER INGELHEIM PHARMACEUTICALS, INC. (formerly, Boehringer Ingelheim, Ltd.)

DECISION

for Redetermination of a Deficiency or for Refund of Franchise Tax on Business Corporations under Article 9-A of the Tax Law for the Year 1979.

Petitioner, Boehringer Ingelheim Pharmaceuticals, Inc. (formerly, Boehringer Ingelheim, Ltd.), 90 East Ridge, P.O. Box 368, Ridgefield, Connecticut 06877, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the year 1979 (File No. 44864).

A hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 6, 1985 at 1:15 P.M., with all briefs to be submitted by September 1 1985. Petitioner appeared by Brian E. Andreoli, Esq., Director of Taxes. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly required petitioner to file a combined franchise tax report with its wholly-owned subsidiary, a Delaware corporation which does not do business in New York.

11. Whether so requiring a combined report constitutes an impermissible burden upon interstate commerce.

FINDINGS OF FACT

1. On March 25, 1983, the Audit Division issued to Boehringer Ingelheim, Ltd. a Notice of Deficiency, asserting franchise tax due under Article 9-A of the Tax Law for the taxable year 1979 in the principal amount of $111,419.00, plus accrued interest. The asserted deficiency was predicated on the filing of a combined franchise tax report, embracing Boehringer Ingelheim, Ltd. and its wholly-owned subsidiary, Bilchem Ltd. ("Bilchem").

2. On December 31, 1984, Boehringer Ingelheim, Ltd. changed its name to Boehringer Ingelheim Pharmaceuticals, Inc.

3. On or about June 15, 1983, petitioner remitted to the Audit Division payment for the asserted deficiency with interest, solely to stop the accrual of interest upon the deficiency. Petitioner thereafter submitted a claim, and a petition, for refund.

4. Boehringer Ingelheim Pharmaceuticals, Inc. is a Delaware corporation, incorporated on March 2, 1971 as a wholly-owned subsidiary of Pharma-Investment Ltd., an Ontario corporation. It is licensed to do business in New York and in 1979, filed a separate franchise tax report, allocating its income in accordance with its property, sales and payroll within and without this state. Bilchem was incorporated on December 21, 1977 as a Delaware corporation, and is a wholly-owned subsidiary of Boehringer Ingelheim Pharmaceuticals, Inc. Since its incorporation through to date, Bilchem has had: no property in New York owned, leased or used for its benefit; no employees in New York; and no sales, directly or indirectly, to customers located in New York. Bilchem is not licensed to do business in New York State, nor does it seek permission to do business in this state.

5. Bilchem is engaged in the manufacture of dipyridamole, the active ingredient in the finished pharmaceutical, Persantine. Persantine is a registered trademark which has been licensed to petitioner by Boehringer Ingelheim International GmbH.

6. Prior to the organization of Bilchem, dipyridamole was produced by a predecessor manufacturing affiliate (referred to, for simplicity, as the predecessor manufacturer). During the years 1963 through 1970, Geigy Chemical Corporation ("Geigy") had a licensing agreement with Boehringer Ingelheim GmbH, a West German corporation, to manufacture and sell certain Boehringer Ingelheim GmbH finished pharmaceuticals in the United States. Geigy purchased the active ingredient from the predecessor manufacturer for $550.00 per kilogram from the inception of the agreement to 1970. Geigy was never licensed the right to manufacture the active ingredient dipyridamole, but rather to transform the active ingredient into the finished pharmaceutical form which it was licensed to sell in the United States market. (The active ingredient manufacturer was neither a part of nor a department of Geigy.) In 1970, Geigy's parent corporation announced that it intended to merge with another Swiss corporation, Ciba, a pharmaceutical manufacturer. Boehringer Ingelheim GmbH sought to intervene in an antitrust action filed by the Justice Department for the purpose of asserting antitrust objections to the proposed merger between the two foreign entities. The proposed merger would have combined (and subsequently did combine) their operations, particularly in the United States. Before a final disposition of petitioner's request for intervention, an agreement was reached whereby the original 1963 agreement between C. H. Boehringer Sohn (Boehringer Ingelheim GmbH) and Geigy would be amended to eliminate most of the perceived antitrust objections. As part of the [illegible]

Ingelheim GmbH could form its own U.S. operations to take over the marketing of finished pharmaceutical products from Geigy. The agreement required in part that advance notice be given of a formation of a sales force to market the products, and that prior to the manufacture of the actual finished pharmaceutical products, Boehringer Ingelheim GmbH would give advance notice to Ciba-Geigy that it had an approved facility in which to manufacture the products. In 1973, petitioner took over the active marketing of the finished pharmaceutical product, and in 1981, took over the manufacture of the finished pharmaceutical form of Persantine. Petitioner does not manufacture the active ingredient for dipyridamole nor for any other finished pharmaceutical product.

7. As above-described, Bilchem is a manufacturer of the active ingredient dipyridamole, which is used in the final finished pharmaceutical form of dipyridamole marketed under the trade name Persantine. From the year 1963 through the end of 1978, the predecessor manufacturer of Boehringer Ingelheim Pharmaceuticals, Inc. and Bilchem performed the manufacturing of the active ingredient. For the years 1963 through 1970, this active ingredient was sold to Geigy for $550.00 per kilogram, pursuant to the licensing agreement which had been negotiated between Geigy and Boehringer Ingelheim GmbH. From 1971 through the end of 1978, the predecessor manufacturer sold the active ingredient to Boehringer Ingelheim Pharmaceuticals, Inc. at the same $550.00 per kilogram price. Pursuant to the arrangement of the compromise reached to settle the antitrust action, the active ingredient was sent to the new Ciba-Geigy Corporation for the manufacture of the finished pharmaceutical product through and including the year 1979. In 1979, Bilchem started its active operations and shipped the active ingredient to Ciba-Geigy Corporation for the manufacture of the finished pharmaceutical product as had its predecessor. The selling price of the active

ingredient in 1979 was and still remains at *$550.00* per kilogram. The sales of Persantine, and correspondingly, of dipyridamole, have been increasing dramatical since 1971 (from approximately **$3** million in 1971 to in excess of *$40* million in 1979), thereby enabling the active ingredient manufacturer to more fully utilize plant capacity and amortize costs over larger volumes of product.

8. The technology which is used to manufacture the active ingredient is licensed by Bilchem from Boehringer Ingelheim International GmbH (a successor in name to Boehringer Ingelheim GmbH), for which it pays a royalty. This is the same arrangement which existed with its predecessor manufacturer. Petitioner pays a separate royalty, at the same rate paid by Geigy, for the right to sell the finished pharmaceutical product.

9. There are no personnel at Boehringer Ingelheim Pharmaceuticals, Inc. who can provide technical assistance or replace the technical individuals at Bilchem in the production of the active ingredient, nor could Bilchem employees replace technical employees at Boehringer Ingelheim Pharmaceuticals, Inc. in the production of finished pharmaceutical products. The manufacture of the active ingredient is technically different from the technology needed to combine the active ingredient with other compounds to form a finished pharmaceutical. As evidenced by the Geigy arrangement, the manufacture of the active ingredient is not an integrated part of the manufacture of the finished pharmaceutical form.

10. In 1979, the officers of Bilchem were: Dr. Harvey S. Sadow, president; Kevin Reddington, vice president-finance and chief financial officer; Dr. Horst Haneke, vice president; Philip **J.** Franks, secretary; and Helmut Mueller, treasurer. The directors were Dr. Harvey Sadow, Manfred Koring and Kevin Reddington.

11. The day-to-day operations of Bilchem are conducted by the same individuals who ran the predecessor manufacturer, Dr. Haneke and Mr. Mueller, who are neither officers nor directors of petitioner. The officers of Bilchem who are also officers of Boehringer Ingelheim Pharmaceuticals, Inc. devoted no time in 1979 to the operation of Bilchem. The policies and procedures for the daily operations were carried over from the predecessor and are dissimilar from petitioner's operations and procedures. Bilchem's 1979 budget was not submitted to its parent for approval because petitioner did not possess the ability to evaluate the operations of an active ingredient manufacturer. Bilchem establishec its own operating policies for technical production, personnel, finance and general administration. Its employees are not covered by pension or benefit plans similar to those provided by petitioner to its employees. Finally, the accounting policies and procedures at Boehringer Ingelheim Pharmaceuticals, Inc. and those at Bilchem are not alike; this difference is a result of the fact that Bilchem arose out of the business of the predecessor manufacturer, which itself predated the existence of Boehringer Ingelheim Pharmaceuticals, Inc.

12. For 1979, Bilchem's total net sales were $15,294,512.00, of which $8,160,295.00, or 53.35 percent, represented sales to petitioner. Boehringer Ingelheim Pharmaceuticals, Inc. earned a 76 percent gross profit margin on the sale of Persantine, while Bilchem earned a gross profit margin of approximately 68 percent.

CONCLUSIONS OF LAW

A. That section 211.4 of the Tax Law authorizes the Tax Commission, in its discretion, to require or permit a parent corporation and its wholly-owned subsidiary to file a franchise tax report on a consolidated basis

report embracing a corporation not a taxpayer (i.e., a foreign corporation not doing business in New York) cannot be required, however, unless the Commission deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in section 211.5, in order properly to reflect the tax liability under Article 9-A. Thus, in the case at hand, the question resolves itself to whether a combined report will fulfill the underlying statutory purpose of avoiding the distortion of and accurately portraying petitioner's true income. (See Matter of Coleco Industries Inc. v. State Tax Comm., 92 A.D.2d 1008, affd. mem., 59 N.Y.2d 994; and 20 NYCRR 6-2.3, effective for all taxable years ending on or after December 31, 1983.)

B. That petitioner and its wholly-owned subsidiary, Bilchem, have carried over a relationship which existed under a prior agreement negotiated by two independent third parties at arm's length. The selling price of the active ingredient contained in the finished pharmaceutical was established by Geigy and Boehringer Ingelheim GmbH at $550.00 in 1963, and has remained constant over the years by reason of Bilchem's optimal use of its facilities and personnel, The record shows that a greater gross profit margin is realized by petitioner on its sales of Persantine than is realized by Bilchem on its sales of dipyridamol The arm's-length pricing set in 1963 thus appears to retain its economic validity, the intercorporate transactions between petitioner and its subsidiary do not tend to distort or shift petitioner's income, and a combined franchise tax report is not required.

C. That in view of the foregoing, it ***is*** unnecessary to address the second issue presented.

D. That the petition of Boehringer Ingelheim Pharmaceuticals, Inc. is granted, and the Notice of Deficiency issued on March 25, 1983 is cancelled.

DATED: Albany, New York

JAN 17 1986

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER