STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **THE WALT DISNEY COMPANY AND CONSOLIDATED SUBSIDIARIES** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Tax Periods Ended September 27, 2008, October 3, 2009 and October 2, 2010.	: : : : : : :	DECISION DTA NO. 828304

Petitioner, The Walt Disney Company and Consolidated Subsidiaries, and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on May 30, 2019. Petitioner appeared by Pillsbury Winthrop Shaw Pittman, LLP (Marc A. Simonetti, Esq., Andrew D. Appleby, Esq. and Dmitrii Gabrielov, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Jennifer L. Baldwin, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in support of its exception and in opposition to petitioner's exception. Petitioner filed a brief in opposition to the Division of Taxation's exception and in reply to the Division of Taxation's brief in opposition. The Division of Taxation filed a brief in reply to petitioner's brief in opposition. Oral argument was heard on February 6, 2020 in Albany, New York, which date began the six-month period for the issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner has established the amount claimed as royalty payments from its alien affiliates during the years at issue.

II. Whether some of those payments were royalties as defined in Tax Law § 208 (9) (o) (1) (C).

III. Whether petitioner may exclude royalties received from its alien affiliates in the computation of its entire net income pursuant to Tax Law former § 208 (9) (o) (3).

IV. If not, whether denying petitioner such an exclusion under the facts herein violates the dormant Commerce Clause of the United States Constitution.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge.[1] Those facts appear below.

1. Petitioner, The Walt Disney Company and Consolidated Subsidiaries, is a diversified worldwide entertainment company comprised of a group of corporations incorporated within the United States. Petitioner's operations are comprised of five business segments: Media Networks, Parks and Resorts, Studio Entertainment, Consumer Products and Interactive Media.

2. The Media Networks segment includes a domestic broadcast television network (ABC Television Network), television production and distribution operations, domestic television stations, international and domestic cable networks (e.g., ESPN and Disney Channel), domestic broadcast radio networks and stations, and publishing and digital operations.

3. In the Parks and Resorts segment, petitioner owns and operates the Walt Disney World

[1] We have considered and we reject requests for findings of fact made by both parties.

Resort in Florida, the Disneyland Resort in California, the Disney Vacation Club, the Disney Cruise Line and Adventures by Disney. Petitioner also manages and has ownership interests in Disneyland Paris and Hong Kong Disneyland Resort, and licenses the operations of the Tokyo Disney Resort in Japan.

4. The Studio Entertainment segment produces and acquires live-action and animated motion pictures, direct-to-video content, musical recordings and live stage plays. Petitioner distributes produced and acquired films in the theatrical, home entertainment and television markets under such banners as Walt Disney Pictures, Touchstone Pictures, Pixar Miramax and Dimension.

5. The Consumer Products segment engages with licensees, manufacturers, publishers and retailers throughout the world to design, develop, publish, promote and sell a wide variety of products based on existing and new characters and other intellectual property through its merchandise licensing, publishing and retail businesses. Petitioner's worldwide merchandise licensing operations include products such as toys, home décor and furnishings, stationery, accessories, health and beauty, food, footwear and consumer electronics. Petitioner licenses characters from its film, television and other properties and earns royalties, which are usually based on a fixed percentage of the selling price of the products.

6. The Interactive Media Segment creates and delivers Disney-branded entertainment and lifestyle content through interactive media, such as multi-platform games and internet websites.

7. Petitioner’s businesses are affected by its ability to exploit and protect against infringement of its intellectual property, including its trademarks, trade names, copyrights, patents and trade secrets. Petitioner’s intellectual property includes rights in the content of

motion pictures, television programs, electronic games, sound recordings, character likenesses, theme park attractions, books and magazines.

8. Petitioner's New York State corporation franchise tax reports filed for the audit period included all affiliates in petitioner's consolidated federal forms 1120 filed for the tax periods ended September 27, 2008 (FYE 2008) and October 3, 2009 (FYE 2009) and most of petitioner's affiliates included in its consolidated federal forms 1120 for the tax period ended October 2, 2010 (FYE 2010) (collectively the audit period). Both petitioner's state combined reports and federal tax returns include Buena Vista International, Inc., Disney Enterprises, Inc., Disney Interactive Studios, Inc. (f/k/a Buena Vista Games, Inc.), ABC, Inc., Buena Vista Theatrical Group Ltd. and Walt Disney World Company, Inc.

9. Petitioner's combined group members owned 100% of the voting power and value of Buena Vista International, Inc., Disney Enterprises, Inc., Disney Interactive Studios, Inc. (f/k/a Buena Vista Games, Inc.), ABC, Inc., Buena Vista Theatrical Group Ltd., and Walt Disney World Company, Inc., during the entire audit period.

10. On petitioner's original and first five amended New York State forms CT-3-A for FYE 2008, petitioner deducted $355,477.00 on line 15 (other subtractions). On its sixth amended FYE 2008 form CT-3-A, petitioner deducted $1,728,785,592.00 on line 15. Of the $1,728,785,592.00 claimed on line 15, $355,477.00 is not at issue in this matter. The remaining amount was included in the amounts reported on line la (gross receipts or sales), and line 7 (gross royalties), on petitioner's federal form 1120 for FYE 2008. Petitioner agrees that $44,096,153.00 of the $1,728,785,592.00 reported on line 15 of its sixth amended form CT-3-A for FYE 2008 should not have been deducted.

11. On petitioner’s original form CT-3-A for FYE 2009, petitioner deducted $1,583,177,067.00 on line 15. Of the $1,583,177,067.00 reported on line 15, $138,000.00 is not at issue in this matter. The remaining amount was included in the amounts reported on line 1a and on line 7 of petitioner’s federal form 1120 for FYE 2009.

12. On petitioner’s original form CT-3-A for FYE 2010, petitioner deducted $2,179,325,577.00 on line 15. Of the $2,179,325,577.00 reported on line 15, $575,000.00 is not at issue in this matter. The remaining amount was included on line la and line 7 of petitioner’s federal form 1120 for FYE 2010. Petitioner agrees that $5,336,418.00 of the $2,179,325,577.00 reported on line 15 of its FYE 2010 form CT-3-A should not have been deducted.

13. The Division of Taxation (Division) audited petitioner’s combined reports for the audit period. The Division identified the large amounts petitioner reported on line 15 of petitioner’s combined reports during the audit period. On a statement attached to its form CT-3-A for FYE 2009, petitioner described the line 15 amount as “Parent Company Share Adjustment.” No explanation of the line 15 amount was provided for FYE 2010. On its sixth amended form CT-3-A for FYE 2008, petitioner explained that it was amending the return to “[i]nclude a deduction from the combined entire net income base for foreign royalty income under N.Y. Tax Law 208(9)(0)(3).”

14. During the course of the audit, the Division submitted four information document requests (IDRs) to petitioner seeking various information and/or documentation. As is relevant here, in its first IDR to petitioner, IDR#1, dated April 29, 2014, the Division made the following request:

“Support and explanation of CT-3A line (15) deduction for the 09/2009, 09/2010 and 09/2011 periods. In the 09/2009 CT-3A the deduction of $1,583,039,067 is described as 'Parent Company Share Adjustment.'

a. For the 09/2009 period, on what line of the federal consolidated return was the $1,583,039,067 item(s) reported?

b. For the 09/2010 period, a deduction of $2,178,750,577 was deducted on the CT-3A line (15). On what line of the federal consolidated return was the $2,178,750,577 items(s) reported?

c. For the 09/2011 period, a deduction of $2,667,633,394 was deducted on the 3A line (15). On what line of the federal consolidated return was the $2,667,633,394 item(s) reported?

d. What New York State Tax Law section supports the deductions taken on the CT-3A line (15) for the periods ending 09/2009, 09/2010 and 09/2011."

15. Along with its response to the other requests made in IDR#1, petitioner responded to the foregoing inquiry as follows:

"a. For the 09/2009 period, the $1,583,039,067 was reported on line(s) 1A and of the federal consolidated return.

b. For the 09/2010 period, the $2,178,750,577 was reported on line(s) 1A and 7 of the federal consolidated return.

c. The 09/2011 period is not included in the scope of this audit.

d. New York Tax Law § 208.9(o)(3) which allows royalty income received from a related corporation to be excluded from the recipient's taxable income provided the deduction for such royalty income is required to be added back to the payer's taxable income under § 208.9(o)(3) supports the deductions taken on the CT-3A line (15) for the periods ending 09/2009 and 09/2010."

16. On January 9, 2015, the Division sent IDR#2 to petitioner. This IDR posed no questions nor requested documentation on the royalty income exclusion previously identified.

17. Subsequently, on November 16, 2016, the Division sent IDR#3 to petitioner, which requested support for the line 15 amounts, including the statutory authority for such deduction

and a breakdown by payer and amount paid.

18. For FYE 2009, petitioner responded as follows:

Legal Entity	Description	Amount
Disney Enterprises, Inc.	DEI-CP Parent Company Share	$498,598,200
Disney Enterprises, Inc.	DEI -Corp Royalty from Magical Cruise Co Ltd	$28,877,289
Disney Enterprises, Inc.	DEI-Corp Royalty from Euro Disneyland	$30,369,733
Buena Vista International, Inc.	BVI Parent co Share	$1,025,193,844
	Total Foreign Royalty Revenue From Related Entities Not in Federal Consolidated Return	$1,583,039,067

19. For FYE 2010, petitioner responded as follows:

Legal Entity	Description	Amount
Disney Enterprises, Inc.	DEI-CP Parent Company Share	$529,660,116
Disney Enterprises, Inc.	DEI -Corp Royalty from Magical Cruise Co Ltd	$22,678,808
Disney Enterprises, Inc.	DEI-Corp Royalty from Euro Disneyland	$60,370,000
Buena Vista International, Inc.	BVI Parent co Share	$1,566,041,653
	Total Foreign Royalty Revenue From Related Entities Not in Federal Consolidated Return	$2,178,750,577

20. Petitioner did not provide detail for FYE 2008 because, at the time, it had yet to amend its FYE 2008 form CT-3-A to include such subtraction.

21. The auditor’s handwritten notes contained in the audit file indicate that she believed that petitioner’s response to IDR#3 Item 5 did not provide much detail. On the auditor’s copy of IDR#3 her handwritten notes that indicate this item was “Done” and that petitioner had responded on January 26, 2016. The audit file makes no mention of petitioner failing to

adequately substantiate the royalty income exclusion claimed or that the amounts claimed were royalties. The auditor’s notes state:

> “Taxpayer deducted foreign royalty income rec’d from a related corporation for the 2009 & 2010 periods. Tp cited NY tax law §208.9(o)(3) in support of the royalties exclusion from income. Audit's position is that royalty income rec'd from related corporations who are NY filers can be excluded from income. Foreign royalty exclusion for the FY 2009 & 2010 periods as filed is disallowed.”

22. During the audit period, petitioner licensed intellectual property to its alien affiliates pursuant to licensing agreements. Petitioner’s alien affiliates are identified in petitioner’s exhibits 1 and 2. There is no dispute that the alien affiliates are related members as defined in Tax Law former § 208 (9) (o).

23. Petitioner’s alien affiliates are entities all organized under the laws of foreign countries, and were not members of petitioner’s New York State corporation franchise tax group because entities organized under the laws of foreign countries were not includable in a franchise tax combined return under the tax law in effect during the periods in issue.

24. Petitioner’s alien affiliates were regarded as non-U.S. entities or owned by related non-U.S. entities for federal income tax purposes during the entire audit period.

25. Petitioner owned at least 30%, directly or indirectly, of the capital, profits or beneficial interest in each of its alien affiliates during the entire audit period.

26. In general, petitioner’s licensing agreements granted the alien affiliates the right, in return for royalty payments, to exploit in specified non-U.S. territories for specified periods of time: Disney characters; copyrights; trade names; literary works; dramatic works; pictorial, graphic works; motion pictures; sound recordings; cruise ship designs; and/or other intellectual property rights.

27. At the hearing in this matter, petitioner presented the testimony of its tax principal, Aaron Solomon. Mr. Solomon oversees the teams that prepare petitioner's federal and state tax returns and manage federal and state tax audits. Mr. Solomon explained the general nature of the licensing agreements and how the payments received by petitioner from its alien affiliates pursuant to these agreements were accounted for on petitioner's books and records and for tax purposes.

28. Petitioner's licensing agreements generally fell into three categories: (i) motion picture or television programming; (ii) consumer products or merchandising; and (iii) other agreements operating a theme park.

29. In the consumer products or merchandise licensing agreements, the foreign affiliate pays petitioner for access to the Disney characters and other Disney materials. Payment is based on undisclosed percentages of gross sales.[2]

30. In the "other" category, the foreign affiliate pays petitioner for the right to operate a [Disney theme park] or a Disney-themed cruise line, including the use of the Disney name and design. Payment is based on undisclosed percentages of gross revenues.

31. Agreements in the motion picture or television programming category include those relating to film distribution. The foreign affiliate pays petitioner for the right to advertise, promote, produce and license the product incorporating licensed property for distribution in a territory. Payment is based on an undisclosed percentage of gross revenues less distribution

[2] During the course of these proceedings, petitioner redacted portions of the license agreements containing trade secrets and other confidential information.

expenses. If distribution expenses exceed the payment, petitioner would be required to reimburse the alien affiliate for the shortfall. Mr. Solomon did not believe that the merchandise licensing or theme park and cruise ship license agreements allowed the payment owed to petitioner to be reduced by the alien affiliate's distribution expenses. Pursuant to these types of agreements, petitioner was required to deliver to the alien affiliate: "[a] new or used, complete, final, full timed 35mm or 16mm positive print and/or non-theatrical video cassettes of the Picture, fully cut, main and end titled, edited, scored and assembled with soundtrack printed thereon in synchronization with the photographic action and fit and ready for exhibition and distribution."

32. Petitioner's combined group entities that licensed this intellectual property to its alien affiliates during the audit period were Buena Vista International, Inc., Disney Enterprises, Inc., Disney Interactive Studios, Inc. (f/k/a Buena Vista Games, Inc.), ABC, Inc., Buena Vista Theatrical Group Ltd., and Walt Disney World Company, Inc.

33. Introduced as exhibit 1 was a schedule prepared by petitioner under the direction and supervision of Mr. Solomon listing intercompany agreements between petitioner and its alien affiliates detailing the payments received by petitioner's combined entities and its alien affiliates during the audit period. The schedule lists the payer, the payee, the specific agreement giving rise to the payments, the term of the agreement, the product line licensed, the territory covered, and the amount paid by tax year. For FYEs 2008, 2009 and 2010, the payments paid by the alien affiliates to petitioner amounted to $1,487,104,221.00, $1,491,821,746.00, and

$1,901,121,890.00, respectively.[3] Mr. Solomon credibly testified that the subject license agreements were collected and the amounts claimed as royalties came directly from petitioner's accounting system. All of the subject license agreements listed were in effect during the entire audit period.

34. Petitioner introduced a second schedule as exhibit 2, which was similar to exhibit 1, except that the agreement, term, product line and territory fields of the spreadsheet were left blank. Mr. Solomon testified that these fields were not filled in because the amounts only constituted approximately 10% of the total foreign affiliate royalties claimed. In all other respects, the exhibits were prepared in the same manner. For FYEs 2008, 2009 and 2010, the payments made by the alien affiliates to petitioner as reflected on exhibit 2 amounted to $197,229,741.00, $91,217,321.00, and $272,292,269.00, respectively.

35. The cumulative total payments received by petitioner from its alien affiliates for licensing its intellectual property rights amounted to $1,684,335,970.00, $1,583,041,076.00, and $2,173,416,179.00 for FYEs 2008, 2009 and 2010, respectively.

36. Petitioner treated the payments from the alien affiliate as royalties for financial reporting purposes.

37. In petitioner's general ledger accounting system, the payments from its alien affiliates were generally booked to the "Parent Company Share-Intercompany" account, with a few booked to a broader "Royalty" account. Mr. Solomon explained that "Parent Company

[3] Redacted copies of the agreements listed in exhibit 1 are set forth as exhibit S to the joint stipulation of facts entered into the record by the parties.

Share-Intercompany" is petitioner's terminology for a royalty coming from a foreign related party to a United States party and it is also the name of an account in petitioner's general ledger for such payments.

38. The payments petitioner received from its alien affiliates were included in its federal taxable income as reported on its federal consolidated income tax returns during the audit period.

39. The alien affiliates' federal informational returns (IRS forms 5471, 8858 and 8865) during the audit period included the alien affiliate royalty payments as expenses in the "Rents, royalties, and license fees paid" and/or "Parent Company Share-Intercompany" line-items.

40. Petitioner did not license from unrelated third parties the intellectual property that it licensed to the alien affiliates, except for a few films that petitioner licensed from third parties and then licensed to its alien affiliates.

41. Petitioner excluded the subject payments from its entire net income during the audit period because it concluded that Tax Law former § 208 (9) (o) permitted the royalty income exclusion as long as the royalty payments were received from a related member, whether or not the related member was a New York taxpayer.

42. The Division asserted that petitioner could not exclude the alien affiliate payments from its entire net income because the alien affiliates were not New York taxpayers, citing Tax Law former § 208 (9) (o) as authority for its position that the royalty exclusion should be disallowed.[4]

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[4] The Division also made other adjustments to petitioner's forms CT-3-A as reflected in the schedules introduced as exhibit K with the stipulation of facts that are not at issue in this matter.

43. Neither the audit supervisor, Mr. Daniel Zagorscak, nor the auditor, Ms. Angelika Moutidis, consulted with the Division's legal counsel prior to disallowing the royalty exclusion claimed by petitioner.

44. On May 8, 2017, the Division issued notice of deficiency L-046397543, which asserted tax of $3,995,511.00, plus interest, for the audit period, and denied petitioner's overpayment claim for FYE 2008.

45. Petitioner timely filed a petition protesting the notice of deficiency.

46. The Division filed its answer to the petition, which generally denied the allegations in the petition, including the allegations that the payments petitioner received from its alien affiliates were royalties.

47. The hearing in this matter was held on June 28 and 29, 2018. In her opening statement, the Division's representative clearly stated that the majority of payments petitioner was seeking to exclude from its entire net income did not constitute royalties.

48. In 2003, the statute in question, Tax Law § 208 (9) (o) was enacted effective for tax years beginning on or after January l, 2003. Subsequently, in 2013, Tax Law § 208 (9) (o) was amended to eliminate the royalty income exclusion provision effective for tax years beginning on or after January 1, 2013.

49. Petitioner subpoenaed Ms. Deborah Liebman to appear and give testimony at the hearing in this matter. Ms. Liebman was the Division's attorney who oversaw its income tax legislation and guidance function in its Office of Counsel during the audit period.

50. Ms. Liebman testified that the Division regularly drafts proposed bills for the New York State Division of the Budget, which the Division of the Budget may incorporate into the

New York Governor’s proposed revenue bills.

51. Ms. Liebman had no specific familiarity with Tax Law former § 208 (9) (o) (3) or recollection of the subsequent amendment of the statute that occurred in 2013.

52. Ms. Liebman testified that Tax Law former § 208 (9) (o) (3) “does not say anything about” the royalty payer having to be a New York taxpayer. Likewise, Mr. Zagorscak testified that Tax Law former § 208 (9) (o) (1) (A) stated that the royalty payer did not have to be a New York taxpayer.

53. Petitioner also subpoenaed Mr. Robert Plattner to appear and give testimony at the hearing in this matter. Mr. Plattner served as the Division’s Deputy Commissioner of Tax Policy from May 2007 through February 2018.

54. Mr. Plattner testified that the Division advises the Governor’s Division of the Budget if the Division believes there are constitutional infirmities with a tax statute.

55. Mr. Plattner testified that he was aware that a tax that discriminates against out-of-state taxpayers violates the Commerce Clause of the United States Constitution and that a state may not impose a tax that discriminates against interstate commerce by providing a commercial advantage to local business.

56. Mr. Plattner further testified that a tax formula that penalizes out-of-state economic activity in favor of in-state economic activity is discriminatory and violates the Commerce Clause.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge first determined that the payments from the alien affiliates to petitioner were royalties as defined in Tax Law § 208 (9) (o) (1) (C). The Administrative

Law Judge found that such payments were made in connection with the licensing of intangible assets, consistent with the terms of the agreements between petitioner and its alien affiliates. The Administrative Law Judge also noted that the Division's auditors appear to have been satisfied that the payments were royalties.

Next, the Administrative Law Judge addressed whether the royalty payments paid to petitioner by its alien affiliates were properly excluded from petitioner's ENI pursuant to Tax Law former § 208 (9) (o) (3). The Administrative Law Judge found that the legislature intended for the royalty income exclusion to work in tandem with the royalty payment add back provision under Tax Law former § 208 (9) (o) (2) to eliminate a common tax avoidance strategy by which corporate taxpayers made deductible royalty payments to controlled affiliates. According to the Administrative Law Judge, the legislature's intent was for such royalty payments to be subject to tax once, by either the payer or the payee, and not to go untaxed ("escape taxation"). The Administrative Law Judge noted that the add back provision does not apply to petitioner's alien affiliates because such entities were not New York taxpayers. He determined, accordingly, that the income exclusion provision should not apply to petitioner. The Administrative Law Judge reasoned that, otherwise, the royalty payments will not be subject to tax at all, an outcome contrary to the legislature's intent. The Administrative Law Judge found that petitioner's interpretation improperly added words to Tax Law former § 208 (9) (o) (3) (i.e., the alien affiliates "would" have been subject to Tax Law former § 208 (9) (o) (2) *if they were New York taxpayers*). The Administrative Law Judge found further support for the Division's interpretation of the statute in the 2013 amendments to Tax Law § 208 (9) (o), by which the royalty income exclusion was repealed. The Administrative Law Judge thus concluded that petitioner improperly excluded the payments at issue from its entire net income.

Finally, the Administrative Law Judge rejected petitioner’s contention that the interpretation of Tax Law former § 208 (9) (o) as applied herein violates the dormant Commerce Clause of the United States Constitution. The Administrative Law Judge determined that Tax Law former § 208 (9) (o) does not impose a heavier burden on royalty payments based on the location of the payer. Rather, the Administrative Law Judge found that the statute subjects royalty payments to tax once regardless of whether the payer is a New York taxpayer. The Administrative Law Judge also noted that the add back and exclusion provisions are triggered only if the payer and payee are related parties as defined in the statute. Accordingly, the Administrative Law Judge concluded that the statute, as applied, does not discriminate against interstate (or foreign) commerce.

The Administrative Law Judge thus denied the petition and sustained the notice of deficiency.

ARGUMENTS ON EXCEPTION

As it did below, petitioner contends that Tax Law former § 208 (9) (o) (3), properly construed, permits the exclusion of the payments at issue. The focus of petitioner’s statutory construction argument is the statute’s use of the word “would.” That is, the statute permits taxpayers to deduct related member royalties unless such royalties “would not be required” to be added back under the royalty add back provision. According to petitioner, considering that the statutory definition of related member expressly includes nontaxpayers, this phrasing means that the royalty income exclusion applies if the royalty is the *type* that *would* be required to be added back, regardless of whether it *is* added back. In other words, petitioner contends that, if none of the statutory exceptions to the add back apply, then the income may be excluded. Petitioner asserts that other provisions of the Tax Law and the Divisions regulations use “would” in a similar manner. Petitioner also notes that the legislature could have drafted the statute to expressly require that royalty payments be added back on a New York return for the royalty income exclusion to apply but did not. Petitioner thus contends that the statutory language compels a result in its favor.

Petitioner takes issue with the determination’s conclusion that its interpretation effectively adds words to the statute. To the contrary, petitioner asserts that its interpretation comports with the meaning of “would” as used therein and that it is the Administrative Law Judge’s construction that effectively rewrites the statute to require that the royalty payer be a New York taxpayer for the income exclusion to apply.

Petitioner contends that the determination failed to apply the statute’s unambiguous language and thus impermissibly looked to legislative history and legislative intent for guidance. Petitioner notes that the determination did not expressly find that the statute was ambiguous, but even if it did, petitioner contends that the determination relied on the wrong legislative history. Specifically, petitioner asserts that the determination erroneously relied on the legislative history of the expense add back provision, not the income exclusion provision. Petitioner contends that the determination simply speculates that the legislature’s intent in enacting the expense add back extends to the income exclusion. Petitioner also contends that the determination erroneously found that the 2013 repeal of the exclusion supports its interpretation. Petitioner contends that the legislature’s intent in 2013 has no bearing on its intent in 2003 when the law at issue was enacted. Petitioner further asserts that the determination’s reliance on the Division’s 2013 memorandum in support of the repeal legislation was erroneous. Petitioner contends that this document reflects the Division's concerns regarding the income exclusion that arose after the law was passed in 2003. Petitioner argues that the Division's 2013 memorandum actually supports its position in the present matter because, according to petitioner, it shows the Division's concern that the exclusion statute did not require the related member payer to be a New York taxpayer.

Petitioner also contends that the determination erroneously relied on the Division's policy concerns in interpreting the royalty income exclusion statute. Petitioner asserts that the "escape from taxation" outcome decried in the determination can also effectively occur under the Division's interpretation, such as when the related member royalty payer is a New York taxpayer with a negligible business allocation percentage (BAP). Under that scenario, according to the Division's interpretation, the payee gets the income exclusion because the taxpayer-payer adds back the royalty payment. However, given the payer's very low BAP, very little tax will ultimately be paid to New York on the added-back royalty. Hence, according to petitioner, the concern that royalty payments between related members might go untaxed is not a reason to favor the Division's interpretation. Petitioner further contends that, even if these policy considerations were justified, the determination's interpretation is impermissible because such policy considerations cannot override the plain statutory language.

As it did below, petitioner also asserts that the determination's application of the royalty income exclusion in the present matter discriminates against interstate and foreign commerce in violation of the dormant Commerce Clause of the United States Constitution. According to petitioner, the application of this provision is discriminatory because it conditions the benefit of the exclusion on whether the alien affiliates are New York taxpayers with U.S. taxable income. In other words, according to petitioner, the determination's interpretation results in disparate treatment based solely on the extent of the related member's New York activities. Petitioner thus argues that the statute as applied forecloses tax-neutral decisions by discriminating against out-of-state intellectual property licensing activity and thereby puts pressure on taxpayers to conduct such licensing activity with affiliates that do business in New York.

Petitioner also contends that the determination's interpretation of the royalty income exclusion violates the fundamental statutory construction principle that statutes must be interpreted to avoid constitutional infirmities. Petitioner asserts that its interpretation passes constitutional muster and therefore must be preferred to the determination's, even if the royalty income exclusion is reasonably open to two interpretations.

Petitioner also argues that the determination's constitutional analysis is fundamentally flawed because it does not analyze similarly situated taxpayers. According to petitioner, the proper analysis here is a comparison between a taxpayer parent-taxpayer subsidiary and a taxpayer parent-nontaxpayer subsidiary, similarly situated in all other respects. Petitioner contends that the determination improperly compared petitioner's related entity transactions to similar transactions between non-related entities.

Petitioner contends that the "subject to tax once" outcome of the royalty add back and income exclusion provisions does not render the income exclusion constitutional as applied in the present matter because such an outcome relates only to the tax base of the related members, not their tax burden. Petitioner notes that, as discussed, the difference in tax burden between a taxpayer like petitioner who loses out on the exclusion under the Division's interpretation and the parent of a subsidiary with a minimal New York presence under the same interpretation is significant. According to petitioner, the impact of a tax is discriminatory even if the income is always included in one entity's tax base because it imposes a heavier tax burden on a New York parent that engages in intellectual property licensing activity with non-New York subsidiaries.

In response, the Division asserts, first, that the relevant statutes should be interpreted strictly against petitioner in accordance with the statutory construction rule for exemptions and exclusions as described in ***Matter of Wegman's Food Mkts., Inc. v Tax Appeals Trib. of the State of N.Y.*** (33 NY3d 587 [2019]).

The Division agrees with the determination's conclusion that, under the statutory scheme in effect during the period at issue, a royalty recipient cannot deduct royalty payments if those payments are not also required to be added back by the related party royalty payer. The Division contends that the deduction is prohibited because, in the language of Tax Law former § 208 (9) (o) (3), the royalty payments at issue "would not be required to be added back" because petitioner's alien affiliates are not New York taxpayers and are thus not subject to Tax Law former § 208 (9) (o) (2). Hence, the alien affiliates "would [never] be required" to add back the royalty payments. The Division echoes the determination's finding that petitioner's proposed interpretation reads words into the statute (i.e., the alien affiliates "would" have been subject to Tax Law former § 208 (9) (o) (2) *if they were New York taxpayers*). In addition to the requirement that the royalty payer be a New York taxpayer, the Division asserts that the term "would" conditions the availability of the deduction on whether one of the three statutory exceptions applies. The Division contends that only a royalty payer that is a New York taxpayer "would" be required to add back a royalty payment "under" Tax Law former § 208 (9) (o) (2).

According to the Division, then, the reference in Tax Law former § 208 (9) (o) (3) to "related member," a term that includes nontaxpayers, does not support petitioner's position. The Division notes further that Tax Law former § 208 (9) (o) (2) requires the add back for royalty payments to related members and thus requires the add back whether or not such royalty payments are made to a New York taxpayer.

The Division also argues that its interpretation of Tax Law former § 208 (9) (o) (3) is consistent with the legislative history of Tax Law former § 208 (9) (o) (2), as well as the 2013 amendments of those provisions. The Division cites its own memoranda in support of the enactment of the expense add back in 2003 and the repeal of the income exclusion provision and modification to the expense add back in 2013.

The Division also contends that Tax Law former § 208 (9) (o) (3), as applied, does not discriminate against interstate or foreign commerce. The Division denies petitioner's claim that that provision, as interpreted in the determination, favors New York taxpayers. The Division's argument relies on the notion, discussed above, that the royalty payments are subject to tax once whether the related member royalty payer is a New York taxpayer or not. The Division asserts that the royalty income exclusion and deduction add back provisions must be construed as a whole and that petitioner's argument on this issue improperly considers these provisions in isolation. The Division further contends that the complimentary exclusion and add back features of Tax Law former § 208 (9) (o) distinguish the present matter from the cases cited by petitioner in support of its position.

In support of its own exception, the Division asserts that the determination improperly found that payments by the alien affiliates pursuant to agreements to distribute motion pictures and television programs were royalties under the statutory definition. The Division contends that, while there may be intellectual property rights in a motion picture or television program, payments for the distribution of these “complete and final” products are not directly connected to such intangible assets. The Division further contends that the fact that petitioner receives no payment and is required to reimburse its alien affiliates for their distribution costs if distribution revenues are insufficient confirms that the distribution agreements do not license intangible assets, contrary to the determination. The Division notes also that petitioner reported payments from its distribution agreements on its tax returns as gross receipts and not gross royalties.

Additionally, the Division contends that petitioner failed to prove the amount of the payments it seeks to deduct as royalty payments.

In response to the Division’s exception, petitioner asserts that it proved that the arrangements between the alien affiliates and Buena Vista International, Inc. were intellectual properties (IP) licensing transactions and that the payments to Buena Vista from the alien affiliates were royalties. Petitioner asserts that royalty payments are broadly defined in Tax Law § 208 (9) (o) (1) (C). Petitioner notes that the auditors were satisfied that the payment to Buena Vista were royalties; that the agreements between Buena Vista and the alien affiliates are structured as and use the language of IP licensing agreements; that the agreements would be considered IP licensing agreements under federal law; that its tax principal credibly testified regarding the agreements; and that its redaction of portions of the agreements in the record should not undermine the credibility of those documents for purposes of this matter.

Petitioner also opposes the Division’s claim that petitioner failed to prove the royalty amounts paid by the alien affiliates. Petitioner notes that this was not an issue on audit and that it was raised at the hearing for the first time. Petitioner notes that its tax principal testified credibly regarding the amount of the royalty payments at issue. Petitioner notes that the Division offered no evidence to rebut the documentation or the testimony presented to show the amount of the subject payments.

On the question of statutory construction, petitioner takes the position that language of Tax Law former § 208 (9) (o) (3) is unambiguous and thus leaves no room for interpretation. Even allowing for ambiguity, petitioner contends that, as an exclusion, this provision must be construed in its favor. Petitioner contends that the rule to the contrary as expressed in ***Matter of Wegman's Food Mkts., Inc. v Tax Appeals Trib. of the State of N.Y*** is dicta and that the concurring opinion in that case more accurately states the law (33 NY3d at 596-602).

OPINION

Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (Tax Law § 209 [1] [a]). Corporations located within the Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (Tax Law former § 209-B). During the years at issue, corporations reported their article 9-A tax liability on the greatest of four alternative bases, one of which was entire net income (ENI) (Tax Law former § 210 [1]). Petitioner reported its liability during the years at issue on the ENI base (Tax Law former § 210 [1] [a]).

ENI is generally the taxpayer's entire federal taxable income with modifications that either add to or subtract from federal taxable income (Tax Law former § 208 [9]). During the years at issue, ENI consisted of investment income and business income (Tax Law former § 208 [6], [8]).

Investment income was allocated to New York using the investment allocation percentage (Tax Law former § 210 [3] [b]). Business income was allocated to New York using the business allocation percentage (BAP) (Tax Law former § 210 [3] [a]). These allocated amounts were totaled to arrive at the ENI base, which was subject to tax at the applicable rate (Tax Law former § 210 [1] [a]).

We first address the Division's contention that petitioner failed to prove the amount of the payments claimed as royalties during the years at issue. Petitioner bears the burden to overcome the asserted deficiency (***Matter of Grace v New York State Tax Commn.***, 37 NY2d 193, 195 [1975] ***rearg denied*** 37 NY2d 816 [1975], ***lv denied*** 338 NE2d 330 [1975]; Tax Law § 1089 [e]). As the Division correctly notes, this includes establishing the accuracy of the amount it seeks to exclude from its ENI as royalty payments. It is unclear from the record when the Division first raised this issue. The notice of deficiency was premised solely on the Division's position that petitioner's deduction of claimed royalty payments from its federal taxable income in computing its ENI was contrary to Tax Law former § 208 (9) (o) (3) (***see*** finding of fact 42) and the Division's answer does not raise this issue. The Division did, however, raise this issue in its opening statement at the hearing. The Division may raise an alternate ground for an assessment so long as the petitioner is afforded sufficient notice and an opportunity to be heard (***see Matter of Clark***, Tax Appeals Tribunal, September 14, 1992).

While petitioner denies the Division's contention, it makes no procedural objection. That is, it does not contend that the timing in raising this issue was fundamentally unfair or contrary to the principles of due process (***see Matter of Sholly***, Tax Appeals Tribunal, January 11, 1990 [procedural improprieties that raise fairness or due process concerns may require a shift in the burden of proof]). Hence, we do not address that question.

With respect to the merits of the Division's contention, we defer to the Administrative Law Judge's finding that Mr. Solomon, petitioner's tax principal, credibly testified that the amounts claimed as royalties came directly from petitioner's accounting system (***see*** finding of fact 33). Although we are not bound by an administrative law judge's credibility assessment, we find nothing in this record to alter it (***Matter of Strachan***, Tax Appeals Tribunal, June 28, 2018). We also find it significant in this case that, despite an extensive audit of the records of petitioner's business operations,[5] and despite the number and amount of payments claimed as royalties, neither the audit report nor the auditor's testimony contend that the amount of such payments was inaccurate (***see*** finding of fact 21). Accordingly, we conclude that petitioner's records were accurate with respect to the claimed royalty payments and that petitioner's returns, as modified (***see*** findings of fact 10 and 12), accurately reflect petitioner's records.

We next address whether petitioner's deduction of the royalty payments from its federal taxable income in computing its ENI for the years at issue pursuant to the royalty income exclusion provision under Tax Law former § 208 (9) (o) (3) was proper.

During the period at issue, Tax Law former § 208 (9) (o) (3) stated:

> "Royalty income exclusions. For the purpose of computing entire net income or other taxable basis, *a taxpayer shall be allowed to deduct royalty payments* directly or indirectly *received from a related member* during the taxable year to the extent included in the taxpayer's federal taxable income *unless such royalty payments would not be required to be added back under [Tax Law former § 208 (9) (o) (2)]* or other similar provision in this chapter" (emphasis added).

[5] The tax field audit record, which is in evidence as part of the audit report, shows that 262.50 hours were charged to the audit over three-plus years.

Tax Law former § 208 (9) (o) (2), referenced above, is the royalty expense add back. That provision requires a taxpayer to add back royalty payments made to a related member in computing ENI, to the extent such payments were deductible in calculating federal taxable income, unless one of the following exceptions apply: (1) the taxpayer-royalty payer is included in a combined report with the related member-royalty payee; (2) the related member-royalty payee later pays the royalty amounts to an unrelated party during the taxable year; or (3) the royalty payments are made to a non-U.S. related member that is subject to a comprehensive tax treaty with the United States. None of these exceptions apply here.

As to the correct standard of construction of Tax Law former § 208 (9) (o) (3), where, as in the present matter, "the question is whether taxation is negated by a statutory exclusion or exemption, . . . 'the presumption is in favor of the taxing power'" (***Matter of Wegman's Food Mkts., Inc. v Tax Appeals Trib. of the State of N.Y.*** (33 NY3d at 592 quoting ***Matter of Mobil Oil Corp. v Finance Adm'r of City of N.Y***, 58 NY2d 95, 99 [1983]). This means that any ambiguity or uncertainty in the meaning of the statute must be resolved against the taxpayer and that the taxpayer's interpretation of the statute must be not only plausible, but must be the only reasonable construction (***Matter of Charter Dev. Co., L.L.C. v City of Buffalo***, 6 NY3d 578, 582 [2006]). We disagree with petitioner's contention that the court's opinion in ***Wegman's*** on this point is dicta (***see*** 33 NY3d at 592 ["We reiterate our settled rule of construction to ensure consistent application of taxing statutes"]). We thus also disagree with petitioner that we should be guided by the rule expressed in the concurring opinion (***see id.*** at 596-602).[6]

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[6] Indeed, ***Matter of Wegman's*** appears to render meaningless any argument over a statute's classification as an exclusion or exemption.

The language of the statute "is the clearest indicator of legislative intent and courts should construe unambiguous language to give effect to its plain meaning" (***Matter of DaimlerChrysler Corp. v Spitzer***, 7 NY3d 653, 660 [2006]). The statutory language "must be read in [its] context, and words, phrases, and sentences of a statutory section should be interpreted with reference to the scheme of the entire section" (McKinney's Cons Laws of NY, Book 1, Statutes § 97). Ultimately, proper statutory construction focuses on "the precise language of the enactment in an effort to give a correct, fair and practical construction that properly accords with the discernable intention and expression of the Legislature [citation omitted]" (***Matter of 1605 Book Ctr. v Tax Appeals Trib. of State of N.Y.***, 83 NY2d 240, 244, 245 [1994], ***cert denied*** 513 US 811 [1994]).

Turning to our analysis of the statutory language, we note first that there is no dispute that petitioner and its alien affiliates were "related members" as used in Tax Law former § 208 (9) (o) (3). As defined in Tax Law former § 208 (9) (o) (1) (A), that term means an entity or entities that have a controlling interest in another entity or entities. The definition expressly provides that a related member may be a nontaxpayer.

As to whether the alien affiliate payments were royalties, Tax Law § 208 (9) (o) (1) (C) defines royalty payments for purposes of the income exclusion and expense add back as:

> "[P]ayments directly connected to the acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of licenses, trademarks, copyrights, trade names, trade dress, service marks, mask works, trade secrets, patents and any other similar types of intangible assets as determined by the commissioner, and includes amounts allowable as interest deductions . . . to the extent such amounts are directly or indirectly for, related to or in connection with the acquisition, use, maintenance or management, ownership, sale, exchange or disposition of such intangible assets" (Tax Law § 208 [9] [o] [1] [C]) .

The Division challenges payments made pursuant to agreements between Buena Vista International, Inc. and certain alien affiliates to distribute motion pictures and television programs (***see*** finding of fact 31). These agreements are in the form of licensing agreements pursuant to which the licensor (Buena Vista International) grants to the licensee (the alien affiliate) the right to advertise, promote, produce and license the product for distribution in a specific geographical area (***id.***). Copyright protection extends to "motion pictures and other audiovisual works" (17 USC § 102 [6]). Copyright includes the right to distribute copies of the work in physical form and to exhibit the work publicly (17 USC § 106 [1], [4]). The agreements thus show that the challenged payments were for the use, or license to use, Buena Vista International's copyright interests in certain motion pictures and television programming. Payments for the use of copyrights are expressly included in the definition of royalty payments in Tax Law § 208 (9) (o) (1) (C).

In reaching this conclusion, we necessarily reject the Division's contention that payments to distribute complete and final films (***see*** finding of fact 31) are not directly connected to intangible assets. As noted, copyright, which is an intangible asset, includes the right to distribute a work in physical form; here, a complete and final film. We also reject the Division's contention that the structure of compensation under the agreements, whereby the licensee is guaranteed to be reimbursed for its distribution costs (***id.***), indicates that they were not licensing agreements. We agree with petitioner that this feature does not change the nature of the agreements or the character of the payments. Similarly, petitioner's reporting of these payments on its tax returns as gross receipts, rather than gross royalties, does not change their character.

We next address whether the royalty payments from the alien affiliates to petitioner "would not be required" to be added back under Tax Law former § 208 (9) (o) (2). As noted, petitioner argues that, as none of the statutory exceptions to the add back are applicable, then the royalty payments at issue are the type that "would be required" to be added back under Tax Law former § 208 (9) (o) (2). According to petitioner, the payments thus meet the requirement for the income exclusion under Tax Law former § 208 (9) (o) (3) (royalty payments from related member excluded from ENI unless they would *not* be required to be added back under the add back provision).

We agree with petitioner that statute's use of "would" is important to a proper understanding of the conditional clause in Tax Law former § 208 (9) (o) (3). We disagree with petitioner, however, as to the implications of the use of that word here. The Merriam-Webster online dictionary provides that "would" is used in "the conclusion of a conditional sentence to express a contingency or possibility" (merriam-webster.com/dictionary/would [last accessed July 7, 2020]). Petitioner offers that "would" indicates "the consequence of an imagined event or situation" (lexico.com/en/definition/would [last accessed July 7, 2020]). The phrase "would not be required to be added back" in Tax Law former § 208 (9) (o) (3) thus requires that we consider or imagine the possible circumstances or situations under which related member royalty payments would not be required to be added back under Tax Law former § 208 (9) (o) (2). As petitioner correctly observes, such payments would not be required to be added back if any of the three statutory exceptions in Tax Law former § 208 (9) (o) (2) applied. Contrary to petitioner's contention, however, related member royalty payments also plainly would not be required to be added back if the related member-royalty payer is not a New York taxpayer. Nontaxpayers, of course, are not subject to Tax Law former § 208 (9) (o) (2).

Petitioner correctly notes that this straightforward interpretation of “unless such royalty payments would not be required to be added back under [Tax Law former § 208 (9) (o) (2)]” in Tax Law former § 208 (9) (o) (3) means that the related member-royalty payer must be a New York taxpayer for the related member-royalty payee to claim the income exclusion. Petitioner asserts that this is an incorrect interpretation of the statute. We disagree.

Contrary to our interpretation here, petitioner argues that the word “would” in the income exclusion statute, as opposed to “were,” means that the royalty payments do not *actually* have to be added back, so long as they *would* have to be added back *if* the related member royalty payer was a New York taxpayer. Citing Tax Law § 210-C (2) (c) and 20 NYCRR 6-2.5 (b), petitioner contends that the Tax Law and the Division’s regulations have used “would” in this manner. These provisions, however, are clearly distinguishable from Tax Law former § 208 (9) (o) (3). As relevant here, each such provision refers to “a corporation . . . that/which would be taxable . . . if subject to tax” (***see*** Tax Law § 210-C [2] [c], 20 NYCRR 6-2.5 [b]). The statute and regulation cited by petitioner thus expressly define the circumstances under which the entity “would be taxable,” i.e., “if subject to tax.” In contrast, Tax Law former § 208 (9) (o) (3) contains no language limiting the circumstances under which related member royalty payments “would not be required” to be added back. It is reasonable, therefore, to consider all such circumstances, including where the royalty payer is not a New York taxpayer.

Petitioner also contends that, considering that the add back provision applies only to taxpayers and the income exclusion applies to royalty payments received from a related member, a term that includes nontaxpayers, the legislature intended for the income exclusion to apply to royalty payments made by a related member that is not a taxpayer. We disagree. As discussed above, the possible circumstances under which royalty payments "would not be required" to be added back includes payments by a nontaxpayer-related member. The use of the term "related member" in the income exclusion statute is consistent with this interpretation. Indeed, related member status is the entire basis for the expense add back and income exclusion statute.

Our explication of the language of Tax Law former § 208 (9) (o) (3) comports with the overall statutory scheme of Tax Law former § 208 (9) (o) (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 97). Both the add back provision in subparagraph (2) and the income exclusion provision in subparagraph (3) were enacted together (***see*** L 2003, chs 62, 63, 686). The add back was intended to eliminate a loophole by which a corporation reduced its ENI base by transferring intangible assets to a related corporation and paid a royalty for the use of such assets (***see*** New York Bill Jacket, 2003 S.B. S5725, Ch 686 Part M). By denying a deduction, the add back subjects a taxpayer-royalty payer to franchise tax on royalties paid to a related member (with certain exceptions not relevant here). As discussed, the income exclusion provision is conditioned on the application of the add back. Where both the royalty payer and payee are New York taxpayers, the add back and income exclusion together simply shift the incidence of tax on the royalties from payee to payer and also avoid subjecting the same revenue to franchise tax twice. Considering the language of Tax Law former § 208 (9) (o) as a whole, and the express intent of the add back provision, we find that the legislature did not intend for a taxpayer to gain the benefit of the income exclusion under subparagraph (3) without the corresponding cost to a related member of the add back under subparagraph (2).

Our interpretation of Tax Law former § 208 (9) (o) (3) draws no inference from the 2013 repeal of that provision (***see*** L 2013 ch 59). We agree with petitioner that the Statement in Support of Chapter 59 of Part E of the Laws of 2013 (i.e., the repeal legislation) provides no insight as to the legislative intent underlying the 2003 enactment of that provision. We also agree with the Administrative Law Judge that the same statement does not support petitioner's interpretation of the statute.

We thus conclude that the determination's construction of Tax Law former § 208 (9) (o) (3) was reasonable. Accordingly, petitioner's proposed construction, while not unreasonable, may not prevail (***see Matter of Wegmans***, 33 NY3d at 592). We further conclude, therefore, that petitioner has failed to establish entitlement to the claimed royalty income exclusion.

We now address petitioner's contention that the determination's interpretation of Tax Law former § 208 (9) (o), affirmed herein, violates the Commerce Clause of the United States Constitution (US Const, art I, § 8, cl 3). Although we lack jurisdiction to consider the constitutionality of a statute on its face (***Matter of A & A Serv. Sta., Inc.***, Tax Appeals Tribunal, October 15, 2009), we may consider the constitutionality of a statute as applied to a specific set of facts (***Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003). Accordingly, to the extent that petitioner's constitutional claim is an as-applied challenge, we consider it now. Petitioner bears the burden to prove its as-applied constitutional challenge (***Matter of Brussel***, Tax Appeals Tribunal, June 25, 1992).

The Commerce Clause gives Congress affirmative authority to regulate commerce between the states and with foreign nations. The clause also has an imputed component that limits State authority to "regulate in a manner which affects interstate commerce" (***Matter of Tamagni v Tax Appeals Trib. of State of N.Y.***, 91 NY2d 530, 539 [1998], ***cert denied*** 525 US

931 [1998]).

In ***Complete Auto Transit, Inc. v Brady*** (430 US 274 [1977], ***rehearing denied*** 430 US 976 [1977]), the Supreme Court outlined a four-pronged test to determine whether a state tax violates the dormant Commerce Clause. To be valid, a state tax must: (1) have a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the state (***id.*** at 279). If foreign commerce is implicated, additional scrutiny is required (***Japan Line, Ltd. v County of Los Angeles***, 441 US 434, 451 [1979]).

Petitioner contends that Tax Law former § 208 (9) (o) as interpreted herein discriminates against interstate and foreign commerce under the third prong of the ***Complete Auto Transit*** test. Specifically, petitioner contends that the royalty income exclusion is discriminatory because a New York related member-royalty payee's income exclusion is conditioned on the New York State activity of its related member royalty payer. As discussed, under Tax Law former § 208 (9) (o), petitioner, a taxpayer-related member that receives royalty payments from a nontaxpayer-related member, may not deduct such payments in calculating its ENI, while an otherwise similarly situated taxpayer-related member that receives royalty payments from a related member that is a taxpayer may deduct such payments. Petitioner thus contends that it has been subject to unlawful discrimination.

We disagree with petitioner's contention. In considering a dormant Commerce Clause violation, "a proper analysis must take the 'whole scheme of taxation into account'" (***Halliburton Oil Well Cementing Co. v Reily***, 373 US 64, 69 [1963] [quotation and citation omitted]). Here, this means considering both the income exclusion and the expense add back components of Tax Law former § 208 (9) (o). Furthermore, case law defines dormant commerce clause discrimination in terms of economic interests, as opposed to the interests of taxable entities (***e.g. Oregon Waste Sys., Inc. v Dept. of Envtl. Quality of Oregon***, 511 US 93, 99 [1994] ["'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter"]; ***New Energy Co. of Indiana v Limbach***, 486 US 269, 273 [1988] [discrimination defined generally as "regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors"]). Accordingly, different treatment of similarly situated taxable entities does not necessarily indicate unlawful discrimination. The expense add back and income exclusion provisions at issue apply only to transactions between related members. As noted previously, in a related member relationship, one or more members owns or controls a controlling interest in the other member or members (Tax Law former § 208 [9] [o] [1] [A]). Related members thus share the same economic interest. Accordingly, we must consider the overall economic interest of the related members in considering whether Tax Law former § 208 (9) (o) (3) as applied unlawfully discriminated against petitioner.

Considered in light of these principles, it is clear that Tax Law former § 208 (9) (o) (3) as applied did not discriminate against petitioner in violation of the dormant Commerce Clause. As discussed, petitioner did not qualify for the income exclusion because its related member alien affiliates were not subject to the expense add back. Petitioner was thus required to include the royalties in its ENI. In the hypothetical comparison of related members similarly situated in all respects except that the royalty payer is also a taxpayer, the payee may exclude the royalties, but the payer is subject to the add back and thus includes the royalties in its ENI. In both instances, a related member pays tax on the royalties. Petitioner pays the tax directly, while its similarly situated counterpart pays the tax indirectly through its controlling interest in its related member. Given the reality of this shared economic interest, we see no advantage for New York taxpayers and no burden on interstate or foreign commerce with respect to such related member transactions (***see Fulton Corp. v Faulkner***, 516 US 325, 331 [1996] [state tax law is discriminatory if it "taxes a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State"]).

We note that the cases cited by petitioner in support of its dormant Commerce Clause claim are distinguishable (***e.g. Kraft General Foods, Inc. v Iowa Dept. of Revenue and Fin.***, 505 US 71 [1992]; ***Westinghouse Elec. Corp. v Tully***, 466 US 388 [1984]; ***Boston Stock Exch. v State Tax Commm.***, 429 US 318 [1977]). None of the cases so cited involve a statute applicable only to entities with a shared economic interest wherein the benefit of a deduction for one such related entity is always offset by the cost of an expense add back to another related entity.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of The Walt Disney Company and Consolidated Subsidiaries is denied;

2. The exception of the Division of Taxation is denied;

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

4. The petition of The Walt Disney Company and Consolidated Subsidiaries is denied; and

5. The notice of deficiency dated May 8, 2017 is sustained.

DATED: Albany, New York
August 6, 2020

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Anthony Giardina
Anthony Giardina
Commissioner