STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
AMO USA, INC.	:	DETERMINATION DTA NO. 824550
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2004 through November 30, 2006.	: :	

Petitioner, AMO USA, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2004 through November 30, 2006.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals in New York, New York, commencing at 10:30 A.M. on April 24, 2013, with all briefs submitted by September 26, 2013, which date began the six-month period for the issuance of this determination. Upon notice to the parties, this period was extended three months pursuant to 20 NYCRR 3000.15(e)(1). Petitioner appeared by McDermott Will & Emery, LLP (Thomas H. Donohoe, Esq., and Maria P. Eberle, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (David Gannon, Esq., of counsel).

ISSUE

Whether patent license fees were properly subject to sales tax as part of the sale of tangible personal property.

FINDINGS OF FACT

On April 24, 2013, the parties entered into a Joint Stipulation of Facts and Exhibits, which contained 42 separately numbered paragraphs. The stipulated facts set forth therein have been incorporated into the facts below to the extent they are relevant and proper findings.

1. Petitioner, AMO USA, Inc. (AMO), was formerly known as VISX USA, Inc., and was a subsidiary of VISX, Inc. In 2005, Advanced Medical Optics, Inc., acquired the stock of VISX, Inc., and VISX USA, Inc., changed its name to AMO USA, Inc. Because the period selected for audit, March 1, 2004 through November 30, 2006 (audit period), included dates both before and after the acquisition, some of the relevant transactions involved VISX, Inc., and VISX USA, Inc. For convenience, where relevant, all such entities will be referred to collectively as petitioner herein.

2. During the audit period, petitioner was engaged in the development, manufacture and distribution of surgical procedures and technologies involved in the surgical correction of refractive errors in the human eye that cause conditions such as nearsightedness and farsightedness, i.e., myopia and hyperopia, respectively.

3. In the eye, light passes through the transparent front segment, known as the cornea, and then through a lens to the rear area of the eye. In an eye that produces clear images, the cornea and the lens serve to focus the light precisely on an area at the rear of the eye known as the retina. When an eye does not focus light precisely onto the retina the result is blurred vision.

4. In persons with nearsightedness, the eye may have a defective cornea, eye shape or natural lens, which causes refractive errors that result in light being focused in front of the retina. This defect causes blurred vision. Refractive errors have been treated with corrective lenses, which serve to properly focus light rays on the retina.

5. As an alternative to corrective lenses, refractive errors can be treated with surgical procedures that change the curvature of the cornea to properly refract light onto the retina and produce a clear image.

6. Beginning in the 1970s, surgical correction of refractive errors involved surgeons making a series of incisions in the cornea which, when healed, would change the curvature of the cornea. This procedure was known as radial keratotomy.

7. A decade later, excimer laser technology was discovered, permitting the use of lasers on corneas. The excimer laser uses a beam of ultraviolet light that does not generate heat to reshape the cornea by removing microscopic layers of tissue. The use of the excimer laser to remove tissue is known as photorefractive keratotomy (PRK) and can accurately correct higher levels of refractive error than radial keratotomy.

8. Beginning in the mid 1980s, petitioner and other companies developed and patented surgical methods to use an excimer laser to assist surgeons in performing corneal procedures. In addition, petitioner and other companies developed and patented various types of apparatuses used to perform the surgery.

9. In the early 1990s, researchers discovered that laser assisted surgery on the cornea could be more effective if the outer layer of the cornea was first removed so that the laser energy could be delivered directly to the interior of the cornea. This procedure was called LASIK surgery.

10. Under United States patent law, the patents issued to petitioner covering the methods and apparatus used to perform laser assisted surgery create an enforceable right against the unauthorized use of petitioner's methods and apparatus covered by the patents for a limited period of time. Gerald Mossinghoff, Esq., former United States Commissioner of Patents and Trademarks, credibly testified that patents granted by the United States government similarly

bestow upon owners "the right to prevent others from making, using, selling or importing the inventions as described in the claims of patent."

11. Since 1985 and through the audit period, petitioner applied for and received 56 United States patents related to performing ultraviolet laser corneal surgery. During the audit period, petitioner granted a nonexclusive license to 65 United States patents to perform ultraviolet laser corneal surgery. However, six of these expired during the audit period as follows:

a. Patent number 4665913, Method for ophthalmological surgery, expired 6/24/2005;

b. Patent number 4669466, Method and apparatus for analysis and correction of abnormal refractive errors of the eye, expired 1/16/2005;

c. Patent number 4718418, Apparatus for ophthalmological surgery, expired 10/8/2006;

d. Patent number 4721379, Apparatus for analysis and correction of abnorma refractive errors of the eye, expired 6/23/2006;

e. Patent number 4729372, Apparatus for performing ophthalmic laser surgery, expired 7/31/2006; and

f. Patent number 4732148, Method for performing ophthalmic laser surgery, expired 7/31/2006.

12. In the United States, federal law required approval by the Food and Drug Administration (FDA) of surgical procedures using a laser to reshape the cornea. Since 1993, petitioner has applied for and received FDA approval for patented procedures using an excimer laser to correct vision defects such as nearsightedness and farsightedness.

13. The patented procedures that petitioner has developed over time, and which the FDA has approved, allow surgeons to use lasers to correct an increasingly larger range of refractive errors.

14. Petitioner sold excimer lasers in New York during the audit period, but did not lease them. Although the price charged for the excimer laser varied, petitioner always collected sales tax from its purchasers on its nonexempt sales of the excimer laser in New York.

15. When petitioner sold an excimer laser directly to a physician or hospital (purchaser-operator), petitioner also granted its consent to perform surgical procedures covered by its patents by entering into written patent license agreements with the purchaser-operators (procedure patent licenses). These procedure patent licenses gave permission to the purchaser-operators (and surgeons authorized by these licensees) to perform patented and FDA-approved corneal surgical procedures specified in the procedure patent licenses (licensed procedures). Section C. 3 of the Patent License addressing consideration, provided that the stated fee was effective for 24 months and thereafter could be changed without notice. In addition, there is a market for used STAR lasers, marketed by such third-party dealers as Laser Locators, and purchasers of these machines must obtain the same patent license as purchasers who get machines from AMO. Also, where the ultimate operator is not the purchaser of the laser, that individual must execute a patent license agreement as well.

16. During the audit period, petitioner's procedure patent licenses generally provided that peitioner would grant to the licensee a "non-exclusive, non-sublicensable, non-transferable right and license under the Licensed Patents . . . to perform, and permit Authorized Users to *perform the ultraviolet laser corneal surgery procedures* . . . using the [Excimer Treatment] System . . . within the field." (Emphasis added.) The "field" was defined to include "the use of the [Excimer Treatment] System to perform ultraviolet laser corneal surgery procedures . . . limited to those listed in Section(s) B of the attached Schedule(s), which uses have been approved for marketing by the United States [FDA]." Thus, petitioner's procedure patent licenses covered access to

petitioner's intellectual property that included both petitioner's patents and the ability to market its FDA-approved uses.

17. In return for petitioner's procedure patent licenses, the purchaser-operator licensee agreed to pay petitioner the procedure license fee for each approved licensed procedure performed by the purchaser-operator licensee or a surgeon authorized by the purchaser-operator licensee. Depending on the procedure involved, the procedure license fee was either $100.00 or $235.00 per procedure. Christopher Carr, the Director of Finance for Abbott Medical Optics, attested to the fact that petitioner charged a per procedure fee rather than a front loaded flat fee to reach a wider market among physicians who did not perform a large volume of surgeries.

18. Petitioner's $100.00 per procedure license fee included the following FDA-approved uses and patented procedures: phototherapeutic keratectomy (PTK); PRK; PRK for astigmatism; high myopia with and without astigmatism; STAR S2™ Smoothscan; PRK hyperopia; laser in situ keratomileusis (LASIK) for myopia with or without astigmatism; STAR S3 ACTIVETRAK®; PRK hyperopic astigmatism; VSS™ Blend Zone; LASIK for hyperopia with or without astigmatism; LASIK for mixed astigmatism; addition of an auto-centering function to the STAR S3 ActiveTrak® eye tracking system; and the STAR S4 ActiveTrak™ excimer laser system.

19. Petitioner's $235.00 per procedure license fee included the aforementioned uses and procedures provided for $100.00, plus the following additional uses and procedures: Wavefront-guided LASIK for correction of myopic astigmatism using the STAR S4® excimer laser system and WaveScan WaveFront® system; STAR S4-IR® excimer laser system (addition of an iris identification and registration system to the STAR S4 excimer laser system and WaveScan

WaveFront system); and WaveFront-guided LASIK for correction of mixed stigmatism using the STAR S4-IR® excimer laser system with VSS™ and WaveScan and WaveFront® system.

20. To the extent that petitioner developed or enhanced its technology during the period of time covering the procedure patent license (e.g., obtained additional patents or expanded the FDA-approved uses for the devices), these developments or enhancements were not automatically included in the procedure patent licenses. Paragraph C(2)(2.1) of petitioner's standard form "patent license" provided the purchaser-operator with the option of entering into a subsequent license that would cover the expanded procedures.

21. The procedure license fees were included as a separately identifiable line item on invoices from petitioner to the purchaser-operators in New York. The procedure license fee was invoiced and collected at the time of the sale of the key cards (***see*** Finding of Fact 23).

22. Petitioner did not collect New York sales tax on the amount of the procedure license fees received from New York purchaser-operators.

23. Petitioner also sold plastic key cards that were required to be inserted in the laser in order to perform the patented and FDA-approved surgical procedures and collected sales tax thereon for all sales of the cards in New York that were not exempt. The key cards were equipped with security software to prevent tampering and also controlled the number and types of procedures that could be performed by the excimer laser. To that end, they also had the ability to count the number of procedures actually performed.

24. Petitioner entered into settlement and license agreements with competitors Bausch & Lomb, Lasersight, Inc., and Carl Zeiss-Meditec, Inc., in effect during the audit period, which allowed these companies to manufacture and distribute laser devices covered by patents owned by petitioner and to license to surgeons the right to perform procedures covered by the patents. The

settlement and license agreements required payment of a license fee to petitioner for each procedure performed that used petitioner's patents. The agreements did not restrict the use of petitioner's procedures on machines developed by petitioner. In addition, petitioner received in excess of nine million dollars annually in license fees with its competitors.

25. During the audit period, petitioner timely filed quarterly New York sales tax returns and remitted the sales tax collected.

26. The Division performed and audit of petitioner's sales tax returns for the audit period and assessed additional tax on the total amount of the procedure license fees collected by petitioner from purchaser-operators.

27. The Division issued a Notice of Determination to petitioner, dated March 2, 2009, asserting additional sales tax due of $3,402,739.28, interest of $2,109,037.75 and penalty of $1,361,094.82 for the audit period.

28. By Order, dated May 20, 2011, the Bureau of Conciliation and Mediation Services (BCMS) modified the Notice of Determination, reducing the amount of additional tax due to $1,311,249.21 plus interest. Penalties were canceled.

SUMMARY OF THE PARTIES' POSITIONS

29. Petitioner contends that the patent license fee it charged to customers was a separately identified and invoiced intangible right that was not subject to sales tax, and that its intent was amply demonstrated in the various agreements executed by petitioner and its customers.

30. Petitioner argues that the patent license fee cannot be combined with lasers and key cards and taxed as bundled items of property. However, even if that were the case, petitioner believes the fee for the patent license is not subject to tax because it has demonstrated that the

items may be purchased separately, the charges were separately stated on the invoices and were reasonable in relation to the total charges.

31. Petitioner maintains that the sale of its lasers and key cards is distinct from its patent license on the additional ground that it is not an integrated transaction or a step transaction, as the Division has urged. Petitioner claims that the fee was not an expense passed on to customers and that the patent was not incorporated into the lasers or software.

32. The Division argues that petitioner's charge to customers did not account for the expiration of six patents during the audit period, thus calling into question the validity of the fee charged for the patent licenses and petitioner's claim that the fee was independent of the other charges listed on the invoices.

33. The Division contends that petitioner's charge of a patent license fee was merely an additional cost for the excimer lasers that was "backloaded" in the transaction and was part of a marketing scheme to reach a larger market. The Division cites the fee as just another ploy to increase business and equated it with giveaways of free procedures.

34. The Division maintains that the sale structure developed by petitioner was, in reality, an integrated or step transaction that was borne out by the three agreements customers were required to sign and proved that the patent license and key cards were merely part of the sale of the excimer laser system, each of the former merely a component of the intended result - - the sale of the laser. The Division believes that it was of no import that those sales were portrayed as independent steps because they were so interrelated they could not be considered as such.

35. The Division also argues that the software in the key cards is an indistinguishable part of the software necessary to run the excimer lasers in performing the patented procedures and,

therefore, cannot be considered independent from either the laser or patents for purposes of the sales transaction.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from the sale of tangible personal property. Tangible personal property is defined as "corporeal personal property of any nature" and does not include intangible personal property (Tax Law § 1101[b][6]; 20 NYCRR 526.8[c][2]). Although the provisions of the Tax Law and regulations that address sales and use taxes do not specifically define patents as intangible property, other sections of the Tax Law do (***see*** Tax Law § 208[9][o][1][C]; § 612[r][1][C]; 20 NYCRR 6-2.3[c][3][ii][d]).

B. The importance and value of a patent cannot be understated. The concept originated as "open letters" issued by monarchs to confer rights and privileges under a royal seal and eventually extended to patents of invention, which granted a monopoly for a process or apparatus for a set term. In the United States, Congress adopted the concept, passing the first Patent Act in 1790 to "promote the progress of useful arts." (*The History of Patents*, http:/ /ip-science.thomsonreuters.com/support/patents/patinf/patentfaqs/history.)

Gerald Mossinghoff, Esq., former United States Commissioner of Patents and Trademarks, credibly testified that patents granted by the United States government similarly bestow upon owners "the right to prevent others from making, using, selling or importing the inventions as described in the claims of patent." Hence, the essential and considerable value of a patent is the intangible right vested in its owner to have exclusive authority and control over the procedure, process or apparatus for a term of years, which must be actively protected with constant vigilance. One such protection, utilized by petitioner, is carefully crafting and documenting each and every license granted by the owner to a third party for use of the procedure or apparatus.

As the record here demonstrates, in an effort to protect its patents, petitioner was careful to have each licensee of its patents execute an independent patent license agreement that acknowledged that the VISX Excimer Laser System and its use were covered by numerous patents owned by petitioner, and that certain patents were being licensed to licensees to give them the authority to use the apparatus and methods for performing ultraviolet laser surgery. Most importantly, the licensees acknowledged that the mere purchase of an excimer laser apparatus or a key card did not bestow the authority for performing the patented procedures.

Depending on the procedure to be used, a different license fee was collected. The charge for the patent license fee was separately stated on an invoice that included the key cards, which controlled the Excimer Laser's ability to operate and limited the methods available to the surgeons. No sales tax was collected on the fee charged for the patent license since it was considered the transfer of an intangible right, not the sale of tangible personal property. In contrast, a sales tax was charged and collected on each sale of a key card.

The protection of petitioner's patents was further augmented by the customer sales agreement and the key card agreement, both of which provided in explicit terms that use of the system and the products, like the key cards, was subject to the buyer's agreement to and compliance with the separate patent license agreement, which had to be signed by the buyer prior to the installation of the system and shipment of any products. Further, both the customer sales agreement and the key card agreement provided that the sale of the system and products alone did not constitute an implied license to perform procedures using the system.

The customer sales agreement, the key card agreement and the patent license agreement clearly established both the form and substance of the transaction and the fact that petitioner did not convey its patent rights as part of the sale of the excimer laser system or the key cards. The patent license afforded others the right to use petitioner's patented procedures for a limited, temporary number of operations in consideration of a patent license fee.[1] (***Commissioner v. Hansen***, 360 US 446 [1959] [the incidence of taxation depends upon the substance, not the form of the transaction].) The true nature of a transaction must not be disguised by mere formalisms which exist solely to alter tax liabilities. (***Kornfeld v. Commissioner***, 137 F3d 1231, 1234 [1998].)

The Division argues that the sale of the excimer laser and the key card included an implied right to use it and that the license fee was merely an additional cost of the system that was separately stated to avoid sales tax. The record, however, does not support this interpretation. Based on the discussion above, petitioner took the necessary legal precautions to guard its valuable intellectual property with licensing agreements and separately stated a fee for this on its invoices. The chosen transactional structure respected the discrete identities of the tangible property and intangible property rights that were separately invoiced, indicating that there was no intent to merge the sale of the excimer laser and key cards with the intangible rights conveyed by the patent license. In fact, Mr. Mossinghoff could not comprehend the concept of trying to incorporate the rights conveyed by a patent into a machine or software.

C. In an effort to demonstrate that the licensing of the patents had no independent purpose in the transaction, the Division argues that the fees charged for the patent license had no rational basis because during the audit period 6 of the 65 patents expired and became part of the public domain. The Division reasoned that if fewer patents were included in the license, the value of the license granted should have diminished. Instead, the fees remained constant. The Division's

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[1]Petitioner made a policy decision not to charge a license fee for procedures that were performed by physician's due to medical necessity.

argument would be more persuasive if the 6 patents that entered the public domain were not the oldest and least technologically advanced of the 65. In addition, it appears from the abstracts of those patents cited by the Division in its brief that the apparatus and methods they describe would be used in conjunction with other patented apparatus and methodologies included in the other licensed patents, making independent valuation of the expired patents tricky.

During the audit period, March 1, 2004 through November 30, 2006, petitioner granted licenses for use of the 65 listed patents, and indicated that during the first 16 months none of the patents had expired. Therefore, since the expired patents were in effect for almost half of the audit period, any possible change in the value of the license would only apply to that period and prove even harder to calculate. Since the fees were constant throughout the audit period, it is more than likely the value of the patents as a group did not fluctuate. This interpretation is bolstered by two factors: that the licensees, who are knowledgeable in the field, signed patent license agreements that effectively froze the fee for 24 months without regard for the possible expiration of any patents covered thereunder, and after the initial 24 months, petitioner was free to change the fee without notice, thereby providing for modifications based on a change in patents.

On the record presented, it is impossible to discern whether there was any change in the aggregate value of the patent licenses granted by petitioner, and it is clear that the licenses continued to command the price charged. One would think that competitors in the marketplace would have been able to drive the price of the license fee down if the expiration of the six patents warranted it. For all of these reasons, the Division's contention that petitioner failed to establish a correlation between the license fee and the patents covered thereby is without merit.

D. The Division argues that petitioner "backloaded" a portion of the cost of the excimer lasers by developing a marketing scheme that used the patent license fee as a means to manipulate the taxable portion of the sale, ascribing a separate cost to the grant of authority to use the patent. However, the "pricing scheme" was credibly explained by Christopher Carr, the Director of Finance for Abbott Medical Optics, who said that petitioner charged a per procedure fee rather than a front loaded flat fee to reach a wider market among physicians who did not perform a large volume of surgeries.

The Division's argument rests on the rationale expressed in ***Matter of Zagoren*** (Tax Appeals Tribunal, May 19, 1994), where it was determined that charges for design and consulting work were subject to sales tax where such work resulted in the production of tangible personal property, i.e., brochures, decals, posters and calendars. The basis for the holding was that the receipts from the sale of tangible personal property cannot be broken down into taxable and nontaxable services used in its production, and that the charge for design services rendered by Zagoren was not distinct from the other charges involved in the production of tangible personal property merely because it retained the rights to the actual artwork it created.

The Division believes the creative consulting and design work is analogous to petitioner's patents. However, as noted by petitioner, the patent licenses granted by petitioner to its licensees do not constitute a service rendered to produce tangible personal property. Likewise, the Division garners no support from ***Matter of Artex Systems, Inc. v Urbach*** (252 AD2d 750 [1998]), where fees charged by a professional engineer, while usually exempt from tax, were found to be nondeductible items of expense that were rendered in the same transaction as the sale of tangible personal property. In fact, the Court in ***Artex*** held that the fees were an integral component of the subcontract, which required Artex to provide all engineering necessary for the furnishing of the tangible personal property.

The patent license fees are not analogous to the engineering fees found in ***Artex***, where the engineering services were an integral part of furnishing structurally sound concrete panels and were a contractually required expense borne by Artex as part of the sale of tangible personal property. The patent license fees were agreed to under a separate agreement from the sale of the excimer laser and key cards and did not constitute a sale of tangible personal property or a taxable service. As intellectual property with great value, it was also not an item of expense that was passed through to purchasers of either the lasers or the key cards. Petitioner *owned* the patents and merely granted a license to its customers. The intangible right temporarily transferred was not an expense passed through to its customers (***cf.*** TSB-A-11[32][S][where a patent license fee was an expense passed through to a subsequent purchaser]).

E. The theory behind characterizing the patent license fee as an expense is rooted in Tax Law § 1101(b)(3), which defines a receipt as the amount of the sale price of any property taxable under Article 28 of the Tax Law "without any deduction for expenses." In ***Matter of Penfold v. State Tax Commission*** (114 AD2d 696 [1985]), the court held that dumping fees separately charged and not taxed to customers on receipts for the taxable service of refuse removal were merely expenses of companies in the refuse removal business and therefore subject to sales tax. The reasoning was that the customers were purchasing one service and the disposal or dumping fees were an integral aspect of that service, which "cannot reasonably be reckoned a separate service arising from a different transaction" (***id***. at 697).

The circumstances herein differ substantially from those in ***Penfold***, primarily because the patent license fees were grounded in a separate agreement between petitioner and its customers, designed to protect a valuable intangible right. It was not a cost passed along to customers as part of its transactions, which was a critical element in the conclusions drawn by the Division in its

Advisory Opinion, TSB-A-11(32)S (AO). Rather, the fee was compensation to the patent owner from the person desiring to use that patent right and was independent of the excimer lasers and key cards sold to petitioner's customers.

Although the AO did not contain facts germane to the issue of whether the hardware or software programs were incorporated into the design of the lasers, the Division concluded that if such were the case, the fee charged for the royalty would be an expense pertaining to the sale of software or hardware and therefore taxable under Tax Law § 1101(b)(3). The AO stopped short of addressing the issue of whether the patent was incorporated into the hardware or software due to a failure to provide facts upon which a conclusion could be drawn. Since it has been established that the petitioner in the AO was not the owner of the patent and merely passed on the royalty and key card fees it charged as a pass-through expense, the AO's rationale is not relevant to, and is distinguishable from, AMO's circumstances.

F. The Division also raises the argument that the transaction between petitioner and its customers is an indivisible bundled transaction, and petitioner's attempt to break out the patent license fee as a nontaxable item is improper. Generally, if a single invoice charge includes taxable and nontaxable components, the entire charge is subject to tax (***Matter of LaCascade v State Tax Commn.***, 91 AD2d 784, 458 NYS2d 80 [1982]; ***Matter of Artex Systems, Inc.***; Tax Law § 1132[c]; 20 NYCRR 527.1[b]). However, where taxable and nontaxable items are sold together, as one package, a vendor may collect sales tax on only the taxable portion of the bill (i.e., not collect tax on the nontaxable items) if (1) the taxable and nontaxable items may be purchased separately, (2) the charges are separately stated on the bill and (3) the charges are reasonable in relation to the total charges. (TB-ST-860 [June 16, 2011].) Petitioner convincingly argues that it has met all three of these requirements. As discussed above and noted in the facts, all the items may be purchased separately, and, in fact, the patent license was purchased independent of the excimer laser machines and the key cards by other companies that may or may not use petitioner's hardware, e.g., Bausch and Lomb, Carl Zeiss-Meditec, Inc., and Lasersight Inc. In fact, petitioner receives $9,000,000.00 in license fees annually from its competitors from agreements that do not include the sale of tangible personal property. In addition, there is a market for used STAR lasers, marketed by such third-party dealers as Laser Locators, and purchasers of these machines must obtain the same patent license as purchasers who get machines from AMO. Also, where the ultimate operator is not the purchaser of the laser, that individual must execute a patent license agreement as well.

The invoices reflect that the charges for the patent license fee were always separately stated and the fee charged for the patent license was reasonable. There was no evidence in the record that a different fee was used and, in fact, it is the same price noted and not questioned in TSB-A-11(32)S. Further, the valuation of a patent is unique in that there is no direct competition to the apparatus or procedure in the marketplace. Normally, the fair market value would be established by what a willing seller would offer and a willing buyer would pay, but that is skewed by a seller controlling the apparatus and procedures with its patents.

G. The Division also contends that petitioner's sales of lasers to customers was an integrated transaction, relying on application of the step doctrine. This doctrine is a federal, judicially created doctrine that treats a series of several steps as a single transaction when the steps are integrated parts of a single plan. The courts have applied three alternate tests to determine if application of the doctrine is warranted: the end result test; the binding commitment test; and the mutual interdependence test. (CCH Standard Federal Tax Reporter (2014), ¶16,753.044, Corporate Reorganizations; ***True v. US***, 190 F3d 1165[1999].)

Although not specifically identified by the Division, it appears that it believes the end result test is applicable to petitioner's sales transaction. The Division believes the patent license fee was "backloaded" as part of a pricing scheme to maximize its market. However, the Division argues that the reality of the situation was that the only goal was the sale of the excimer laser system. Any attempt to break up the transaction into independent steps belies the true character of the overall transaction.

The step transaction doctrine is usually applied to corporate acquisitions, mergers and liquidations, but in ***Matter of Waterman Investment Company*** (Tax Appeals Tribunal, August 7, 1997), the Tribunal applied it in the context of the real property transfer gains tax. The Division's novel application to the sales transaction herein is ill-fitting and tenuous, given the concepts of integrated and bundled transactions discussed above. However, even if the step doctrine were applied and the end result test utilized, it is determined that the individual step of having customers purchase patent licenses was an intended end result in and of itself, i.e., the protection and preservation of a valuable intangible, the solemnity of which was impressed by the execution of separate contract. (***True v. US***.)

H. The petition of AMO USA, Inc., is granted, and the Notice of Determination, dated March 2, 2009, as modified by the BCMS Order, dated May 20, 2011, is canceled.

DATED: Albany, New York
June 19, 2014

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE