STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **GENZYME CORPORATION** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Period January 1, 2004 through December 31, 2010.	:	DETERMINATION DTA NO. 828091

Petitioner, Genzyme Corporation, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under article 9-A of the Tax Law for the period January 1, 2004 through December 31, 2010.

On November 14, 2019, the Division of Taxation, appearing by Amanda Hiller, Esq. (Jennifer L. Baldwin, Esq., of counsel) and petitioner, appearing by Reed Smith LLP (Aaron M. Young, Esq. of counsel), waived a hearing and submitted this matter for determination based upon documents and briefs to be submitted by October 12, 2021, which date commenced the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioner may exclude royalties received from foreign affiliates in the computation of its entire net income.

II. If not, whether denying petitioner such an exclusion under the facts herein violates the dormant Commerce Clause, the Due Process Clause, and the Equal Protection Clause of the United States Constitution, and the Equal Protection Clause contained in the New York State Constitution.

III. If such royalties are excluded from petitioner's computation of its entire net income, whether the royalties must also be excluded from the denominator of its business allocation percentage.

FINDINGS OF FACT

The parties entered into a stipulation of facts, dated May 21, 2021, in connection with this matter. Such stipulated facts have been substantially incorporated into the findings of fact set forth herein except for stipulated facts 35 through 40 which are irrelevant.

Background

1. During the period January 1, 2004 through December 31, 2010, petitioner, Genzyme Corporation (Genzyme as the corporation, or petitioner as the combined filer), was a global biotechnology company with its principal place of business in Massachusetts. Genzyme's product portfolio focused on rare disorders, renal diseases, orthopedics, organ transplant, diagnostic and predictive testing, and oncology.

2. Genzyme developed and thereafter licensed pharmaceutical products for manufacture and/or distribution to related and unrelated third parties.

3. The manufacturing operations of Genzyme and its subsidiaries took place in Massachusetts and overseas. Petitioner's New York State activities consisted of sales and the operation of a laboratory located in Yonkers, New York.

Entity Relationships

4. Genzyme was a corporation organized under the laws of the United States.[1]

5. Genzyme Ireland Ltd. was a corporation organized under the laws of the Republic of Ireland. Genzyme International Holdings, a corporation organized under the laws of the Republic of Ireland, owned 100% of Genzyme Ireland Ltd. SangStat Luxembourg S.a.r.l. (known as Genzyme Global S.a.r.l. beginning April 9, 2008) (Genzyme Global S.a.r.l.), a limited liability company organized under the laws of Luxembourg, owned 100% of Genzyme International Holdings. Genzyme Luxembourg S.a.r.l., a limited liability company organized under the laws of Luxembourg, owned 100% of Genzyme Global S.a.r.l. Genzyme owned 100% of Genzyme Luxembourg S.a.r.l.

6. Genzyme also owned 100% of (i) Genzyme Therapeutic Products Corp., a corporation organized under the laws of Massachusetts, and (ii) Genzyme Therapeutic Products LLC, a limited liability company organized under the laws of Massachusetts. Genzyme Therapeutic Products Corp. owned 1% of Genzyme Therapeutic Products Limited Partnership (GTPLP), a limited partnership organized under the laws of Massachusetts, and Genzyme Therapeutics Products LLC owned the remaining 99% of GTPLP.

Receipt of Royalty Payments

7. During the period January 1, 2004 through December 31, 2010, Genzyme and GTPLP received royalty payments from related entities pursuant to license agreements governing the payer’s exclusive and non-exclusive, transferable licenses under certain intangible property to develop, market, offer for sale, sell and have sold, make, and/or have made Myozyme, Renagel, Cerezyme, Fabrazyme and Thyrogen (jointly referred to as the Products).

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[1] In April 2011, Genzyme was acquired by Sanofi SA, a French multinational pharmaceutical enterprise.

8. The royalty payments were computed by multiplying a set rate by the payers' gross receipts from the sales of the Products in designated territories, less certain expenses and deductions. The royalty payments were not related to the sharing of research and development costs associated with the Products.

9. Genzyme and GTPLP received royalty payments from Genzyme Ireland Ltd. or Genzyme Global S.a.r.l pursuant to an agreement related to the Myozyme product. The amounts of those payments were as follows:

a) 2005 – ($1,271,827.00) (payment made by Genzyme Ireland Ltd. to Genzyme);

b) 2006 – $5,528,348.00 (payment made by Genzyme Global S.a.r.l. to Genzyme);

c) 2007 – $42,457,471.00 (payment made by Genzyme Global S.a.r.l. to GTPLP);

d) 2008 – $57,916,239.00 (payment made by Genzyme Global S.a.r.l. to GTPLP);

e) 2009 – $102,367,359.00 (payment made by Genzyme Global S.a.r.l. to GTPLP); and

f) 2010 – $109,510,956.00 (payment made by Genzyme Global S.a.r.l. to GTPLP.

10. Genzyme received royalty payments from Genzyme Ireland Ltd. or Genzyme Global S.a.r.l. pursuant to an agreement related to the Renagel product. The amounts of those payments were as follows:

a) 2005 – $8,416,464.00 (payment made by Genzyme Ireland Ltd.);

b) 2006 – $48,282,166.00 (payment made by Genzyme Global S.a.r.l.;

c) 2007 – $68,549,591.00 (payment made by Genzyme Global S.a.r.l.);

d) 2008 – $61,376,682.00 (payment made by Genzyme Global S.a.r.l.);

e) 2009 – $55,072,507.00 (payment made by Genzyme Global S.a.r.l.); and

f) 2010 – $52,170,504.00 (payment made by Genzyme Global S.a.r.l.).

11. GTPLP received royalty payments from Genzyme Global S.a.r.l. pursuant to an agreement related to the Cerezyme product. The amounts of those payments were as follows:

a) 2007 – $416,252,000.00;

b) 2008 – $503,839,815.00;

c) 2009 – $320,278,783.00; and

d) 2010 – $212,588,107.00.

12. GTPLP received royalty payments from Genzyme Global S.a.r.l. pursuant to an agreement related to the Fabrazyme product. The amounts of those payments were as follows:

a) 2010 – $14,942,095.00.

13. GTPLP received royalty payments from Genzyme Global S.a.r.l. pursuant to an agreement related to the Thyrogen product. The amounts of those payments were as follows:

a) 2010 – $7,375,492.00.

14. Genzyme and GTPLP were the ultimate recipients of the Royalty Payments. They did not act as a conduit, the Royalty Payments were neither directly nor indirectly paid to, nor incurred by, any unrelated parties during the period January 1, 2004 through December 31, 2010.

15. For federal income tax purposes, petitioner included the Royalty Payments on Line 7, Gross royalties, of its respective consolidated federal forms 1120 for years 2004 through 2010.

Procedural Background

16. During the period January 1, 2004 through December 31, 2010, Genzyme filed New York State forms CT-3-A, General Business Corporation Combined Franchise Tax returns, and forms CT-3M/4M, General Business Corporation MTA Surcharge returns (combined corporation

franchise tax and MTA surcharge returns) with a number of related entities, including but not limited to GTPLP.[2]

17. Genzyme Ireland Ltd. and Genzyme Global S.a.r.l. did not file as part of petitioner's combined corporation franchise tax and MTA surcharge returns. Genzyme Ireland Ltd. and Genzyme Global S.a.r.l. did not file any tax returns with New York State or the United States and did not report any federal taxable income to the United States.

18. Petitioner timely filed combined corporation franchise tax and MTA surcharge returns for the period January 1, 2004 through December 31, 2010. These originally filed combined corporation franchise and MTA surcharge tax returns included the Royalty Payments in petitioner's entire net income.

19. On or about March 26, 2012, the Division of Taxation (Division) commenced a general verification field audit of petitioner's combined corporation franchise tax and MTA surcharge returns for the period January 1, 2004 through December 31, 2010.

20. A review of the Tax Field Audit Record (audit log) indicates that between April 5, 2012 and February 4, 2013, the Division issued a total of 7 information document requests, and a tax shelter letter to petitioner. Further review of the audit log indicates that petitioner provided all requested information by January 31, 2014.

21. Upon completing its review of the information provided, on September 18, 2014, the Division issued a consent to field audit adjustment (September 18, 2014 Consent) and corresponding workpapers to petitioner. The audit log entry for December 8, 2014 indicated that Thomas Hugget, petitioner's Senior Manager – State Tax, responded to the September 18, 2014 Consent via email, in which "[t]he primary area of disagreement involved the disallowance of

[2] GTPLP was included in Genzyme's combined corporation franchise tax and MTA surcharge returns for the years 2006 through 2010.

Other Business Receipts in arriving at the Receipts Factor." The same audit log entry also noted that "[t]he issue of the royalty income exclusion was brought up in this correspondence."

22. During the course of the audit, a series of consents extending the period of limitations for assessment of franchise tax under articles 9 (except section 180), 9-A, 13, 32, 33 and 33A of the Tax Law were executed that extended the statute of limitations for the period January 1, 2004 through December 31, 2011 to December 14, 2015.

23. After reviewing petitioner's response regarding the Division's disallowance of other business receipts, the Division issued information document request (IDR) No. 8 on March 19, 2015. Subsequently, petitioner responded to IDR No. 8 via email on April 28, 2015.

24. On May 13, 2015, petitioner timely filed amended combined corporation franchise tax and MTA surcharge returns for the years 2005 through 2010, on which it deducted the Royalty Payments from its entire net income. The amended combined corporation franchise tax and MTA surcharge returns resulted in requests for refund in the following amounts:

a) for the year 2005: $22,056.05, plus interest;

b) for the year 2006: $230,067.12, plus interest;

c) for the year 2007: $1,653,664.26, plus interest;

d) for the year 2008: $1,919,129.13, plus interest;

e) for the year 2009: $1,293,793.60, plus interest; and

f) for the year 2010: $834,571.43, plus interest.

The refund claims were based upon petitioner's position that the payments represented royalty income received from alien affiliates, and that such royalty income can be deducted from petitioner's federal taxable income in computing its entire net income.

25. The Division reviewed the "information on hand," including the amended combined corporation franchise tax and MTA surcharge returns "claiming refunds attributable to the royalty income exclusion." The audit log entry for July 21, 2015 indicated that the amended combined corporation franchise tax and MTA surcharge returns "did not incorporate the proposed audit adjustments" reflected in the September 18, 2014 Consent "with regards to investment capital, combination, and modifications to ENI." The audit log entry also noted that "[t]he taxpayer did not express disagreement with the proposed adjustments in their response dated December 2014."

26. The Division determined that petitioner could not deduct the Royalty Payments in computing its entire net income during the period January 1, 2005 through December 31, 2010 (Refund Period). The Division also made other adjustments (unrelated to the amounts petitioner deducted as royalty income received from alien affiliates) to petitioner's original combined corporation franchise tax returns for the period January 1, 2004 through December 31, 2010, which such other adjustments are not in dispute in this matter.

27. On July 30, 2015, the Division issued a revised consent to field audit adjustment (July 30, 2015 Consent) and corresponding workpapers incorporating petitioner's amended combined corporation franchise tax and MTA surcharge returns and other information provided by petitioner. The July 30, 2015 Consent proposed to assess additional corporation franchise tax and MTA surcharge for the tax years ending 2004, 2006, 2007, 2008, and 2009 in the total amount of $609,231.00, plus penalties and interest.[3] The July 30, 2015 Consent also proposed to provide a credit for overpayments of corporation franchise tax and MTA surcharge for the tax years ending 2005 and 2010 in the total amount of $408,887.00.

[3] Interest was computed based upon the extended due date of the as-filed returns.

28. The audit schedules in the July 30, 2015 Consent proposed “changes in the Receipts factor,” but did “not modify any of the previous adjustments that had been proposed” in the September 18, 2014 Consent. The July 30, 2015 Consent also addressed petitioner’s amended combined corporation franchise and MTA surcharge returns for the years 2005 through 2010, attributable to the related member royalty income exclusion. The audit schedules in the July 30, 2015 Consent disallowed the deduction for royalty income received from alien affiliates.

29. On November 17, 2015, the Division issued a notice of deficiency, L-043941762, (Notice), which asserted additional corporation franchise tax and MTA surcharge due in the amount of $609,231.00, interest due of $298,748.30, penalties of $60,919.00, and credits in the amount of $408,887.00 for the period January 1, 2004 through December 31, 2010. Interest was computed based upon the due date of the as-filed returns, without regard to extensions and credits on account. The Division imposed substantial understatement penalties under Tax Law § 1085 (k) in the amount of 10 percent of the asserted underpayment. The Notice also denied petitioner’s claims for refund for the Refund Period.

30. Based upon a review of certain additional expenses and deductions, the parties agreed that the payments made pursuant to the Myozyme, Renagel, Cerezyme, Fabrazyme or the Thyrogen agreements should be revised and that the payment amounts at issue for purposes of this matter are:

a) 2006 – Genzyme received Royalty Payments from Genzyme Global S.a.r.l. totaling $16,332,034.00;

b) 2007 – GTPLP received Royalty Payments from Genzyme Global S.a.r.l. totaling $458,709,471.00;

c) 2008 – GTPLP received Royalty Payments from Genzyme Global S.a.r.l. totaling $540,513,310.00;

d) 2009 – GTPLP received Royalty Payments from Genzyme Global S.a.r.l. totaling $408,153,889.00; and

e) 2010– GTPLP received Royalty Payments from Genzyme Global S.a.r.l. totaling $337,041,158.00.

The parties agreed that these Royalty Payments are "royalty payments" for purposes of Tax Law § 208 (9) (o) (1) (C). Such payments were not directly or indirectly paid to, nor incurred by, any unrelated parties during the period January 1, 2004 through December 31, 2010.

31. The parties also agreed that Genzyme, GTPLP, Genzyme Ireland Ltd., and Genzyme Global S.a.r.l. are "related members" for purposes of Tax Law former § 208 (9) (o) (1) (A).

32. Petitioner has since agreed to the Division's audit adjustments included in the Notice (***see*** findings of fact 26, 27, 28 and 29), but for the Division's denial of the deduction of royalty income received from alien affiliates in computing its entire net income. The Division has also agreed to abate all penalties asserted in the Notice. Accordingly, neither of those issues is currently before the Division of Tax Appeals.

33. Therefore, the only issues before the Division of Tax Appeals are whether the royalty payments: (i) can be deducted from petitioner's federal taxable income in computing its entire net income as royalty payments received from related members pursuant to Tax Law former § 208 (9) (o) (3); and (ii) are included in the denominator of the receipts factor of petitioner's business allocation percentage.

34. The parties have stipulated to the following:

(a) If a determination is made that the royalty payments <u>can be deducted</u> from petitioner's federal taxable income in computing its entire net income and <u>are included</u> in the denominator of petitioner's receipts factor of its business allocation percentage, petitioner will be entitled to a tax refund in the amount of $5,052,017.00, plus statutory interest.

(b) If a determination is made that the royalty payments <u>can be deducted</u> from petitioner's federal taxable income in computing its entire net income and <u>are not included</u> in the denominator of petitioner's receipts factor of its business allocation percentage, petitioner will be entitled to a tax refund in the amount of $4,412,860.00, plus statutory interest.

(c) If a determination is made that the royalty payments <u>cannot be deducted</u> from petitioner's federal taxable income in computing its entire net income and <u>are included</u> in the denominator of petitioner's receipts factor of its business allocation percentage, petitioner will not be entitled to any refund and will be liable for additional tax in the amount of $200,344.00, plus statutory interest as reflected in the Notice.

35. Pursuant to 20 NYCRR 3000.15 (d) (6), petitioner submitted 24 proposed findings of fact. In accordance with State Administrative Procedure Act § 307 (1), proposed findings of fact 1 through 3, 5 through 12, 14 through 15, 18, 20, 22, and 24 are supported by the record, and have been renumbered and substantially incorporated herein. Proposed findings of fact 4, 13, 16, 17, 19, and 21 have been modified to more accurately reflect the record, and have been renumbered and substantially incorporated herein, as modified. Proposed finding of fact 23 is rejected as irrelevant.

CONCLUSIONS OF LAW

A. 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 (***see*** Tax Law § 209 [1] [a]). Corporations located or doing business within the Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (***see*** 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) (***see*** Tax Law former § 210 [1] [a-d]). Petitioner reported its liability during the years at issue on the ENI base (***see*** Tax Law former § 210 [1] [a]).

B. ENI is generally a taxpayer's entire federal taxable income modified by specific additions or subtractions (***see*** Tax Law former § 208 [9]). During the years at issue, ENI consisted of investment income and business income (***see*** Tax Law former § 208 [6], [8]). Investment income was allocated to New York using the investment allocation percentage (***see*** Tax Law former § 210 [3] [b]). Business income was allocated to New York using the business allocation percentage (***see*** 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 (***see*** Tax Law former § 210 [1] [a]).

C. One such modification to the ENI base, and relevant here, is for royalty payments made to, or received from, related members. Tax Law former § 208 (9) (o) (3), the royalty income exclusion, was a subtraction modification to ENI that provided:

> "Royalty income exclusions. For purposes 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).

For the years 2005 and 2006, Tax Law former § 209 (9) (o) (2) provided:

> "(A) For the purpose of computing entire net income or other applicable taxable basis, a taxpayer must add back royalty payments to a related member during the taxable year to the extent deductible in calculating federal taxable income.

> (B) The add back of royalty payments shall not be required if and to the extent that such payments meet either of the following conditions:
>
>> (i) the related member during the same taxable year directly or indirectly paid or incurred the amount to a person or entity that is not a related member, and such transaction was done for a valid business purpose and the payments are made at arm's length;
>>
>> (ii) the royalty payments are paid or incurred to a related member organized under the laws of a country other than the United States, are subject to a comprehensive income tax treaty between such country and the United States, and are taxed in such country at a tax rate at least equal to that imposed by this state."

In 2007, Tax Law former § 208 (9) (o) (2) was amended to provide an exception for combined reporting:

> "Except where a taxpayer is included in a combined report with a related member pursuant to subdivision four of section two hundred eleven of this article, for the purpose of computing entire net income or other applicable taxable basis, a taxpayer must add back royalty payments to a related member during the taxable year to the extent deductible in calculating federal taxable income" (Tax Law former § 208 [9] [o] [2] [A]).

Thus, to qualify for the exclusion under Tax Law former § 208 (9) (o) (3), the following conditions must be met: (i) the payments must be royalty payments, (ii) the payments must be received from a related member, and (iii) the related member would be required to add back such payments under Tax Law former § 208 (9) (o) (2).

D. Petitioner and the Division have stipulated that Genzyme, GTPLP, Genzyme Ireland Ltd., and Genzyme Global S.a.r.l. are "related members" pursuant to Tax Law former § 208 (9) (o) (1) (A)[4] (***see*** finding of fact 31), and that the Royalty Payments are "royalty payments" pursuant to Tax Law former § 208 (9) (o) (1) (c) (***see*** finding of fact 30). Therefore, there is no

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[4] Tax Law former § 208 (9) (o) (1) (A) defined related members as 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.

dispute that the first and second requirements to qualify for the royalty income exclusion have been met. Accordingly, the only issue is whether the related members would be required to add back the Royalty Payments under Tax Law former § 208 (9) (o) (2).

E. 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 International Bus. Mach. Corp.*** [Tax Appeals Tribunal, March 5, 2021], citing ***Matter of Wegman's Food Markets, Inc. v Tax Appeals Trib. of the State of N.Y.***, 33 NY3d 587, 592 [2019], 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 International Bus. Mach. Corp.***, citing ***Matter of Charter Dev. Co., L.L.C. v City of Buffalo***, 6 NY3d 578, 582 [2006]).

F. 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 International Bus. Mach. Corp.***, citing ***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 International Bus. Mach. Corp.***, citing ***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]).

G. As noted, petitioner, a taxpayer-related member, receives royalty payments (via Genzyme and GTPLP) from nontaxpayer-related members (Genzyme Ireland Ltd. and Genzyme Global S.a.r.l.). Petitioner argues that 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 member excluded from ENI unless they would *not* be required to be added back under the add back provision).

H. While the present matter was pending, the Tax Appeals Tribunal issued its decisions in ***Matter of Walt Disney Co.*** (Tax Appeals Tribunal, August 6, 2020) and ***Matter of International Bus. Mach. Corp.***, where in both cases the Tribunal held that the royalty income exclusion under Tax Law former § 208 (9) (o) (3) was not available to taxpayers, where, as here, the related member-alien affiliates were not New York taxpayers. The Tribunal also determined that this interpretation of Tax Law former § 208 (9) (o) (3) as applied to the facts in ***Disney*** and ***International Bus. Mach. Corp.***, did not discriminate against foreign commerce as asserted by petitioners in those cases and thus did not violate the dormant Commerce Clause.

I. In ***Disney*** and ***International Bus. Mach. Corp.***, the Tribunal analyzed the statutory language and determined that royalty payments "would not be required to be added back" under Tax Law former § 208 (9) (o) (2) if the royalty payer was not a New York taxpayer. Specifically, the Tribunal found that the plain meaning of "would" as used in Tax Law former § 208 (9) (o) (3) required that the Tribunal consider all circumstances under which the add back of royalties was not required, one of which occurred when the related member was not a taxpayer.

The Tribunal also found that its interpretation of the statutory language, i.e., that the income exclusion was conditioned upon a corresponding expense add back, comported with the overall statutory scheme. The Tribunal noted that both the add back and exclusion provisions were enacted together and that the add back was expressly 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*** L 2003, chs 62, 63, 686; New York Bill Jacket, 2003 SB 5725, 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). 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 thereby 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, the Tribunal concluded in ***Disney*** that the legislature did not intend for a taxpayer to gain the benefit of the income exclusion under subparagraph (3) without the accompanying cost to a related member of the add back under subparagraph (2).

J. In ***Matter of International Bus. Mach. Corp.***, the Tribunal found that the 2013 amendments to Tax Law former § 208 (9) (o) did not support petitioner's claim that the amendments were evidence that the statute had to be interpreted as petitioner claimed. The Tribunal in ***International Bus. Mach. Corp.***, stated its interpretation of Tax Law former § 208 (9) (o) (3) "draws no inference from the 2013 repeal of that provision" (***Matter of International. Bus. Mach. Corp.***, citing ***Disney*** and L 2013 ch 59). In both ***Disney*** and ***International Bus. Mach. Corp.***, the Tribunal found that the legislative history of the repeal statute offered "no insight as to the legislative intent underlying the 2003 enactment of that provision."

K. Petitioner claims the Tribunal's interpretation of the royalty income exclusion in ***Disney*** and ***International Bus. Mach. Corp.*** is "flawed." Petitioner does not assert that the facts in this case are materially different from the facts in ***Disney*** or ***International Bus. Mach. Corp.***, nor does petitioner offer any materially different legal argument from what was argued in ***Disney*** or ***International Bus. Mach. Corp.*** From the arguments presented in the parties' briefs, the royalty transactions between petitioner and its alien affiliates in this case are not materially different than the royalty transactions at issue and analyzed in ***Disney*** or ***International Bus. Mach. Corp.*** As noted, in both ***Disney*** and ***International Bus. Mach. Corp.***, the Tribunal determined that New York State taxpayers may not exclude royalties received from foreign alien affiliates in the computation of their entire net income when the alien affiliates paying the royalties are not New York State taxpayers. Accordingly, petitioner's argument about the interpretation of the royalty income exclusion is rejected. It is further concluded, therefore, that petitioner has failed to establish entitlement to the claimed royalty income exclusion.

L. Petitioner argues that the Division's interpretation of Tax Law former § 208 (9) (o) (3) violates both the United States and New York constitutions. It claims that the Division's interpretation of the statute results in unconstitutional discrimination in contravention of the Commerce, Equal Protection and Due Process clauses. First, it is noted that at the administrative level, statutes are presumed constitutional. The Division of Tax Appeals' jurisdiction as prescribed by its enabling legislation does not include a challenge that a statute is unconstitutional on its face (***Matter of Fourth Day Enters.***, Tax Appeals Tribunal, October 27, 1988; ***Matter of Unger***, Tax Appeals Tribunal, March 24, 1994). Nonetheless, the Division of Tax Appeals can determine the constitutionality of a statute as applied to the specific facts of the case (***Matter of Waste Conversion***, Tax Appeals Tribunal, August 25, 1994). "Petitioner bears the burden to prove its as-applied constitutional challenge" (***Matter of Disney,*** citing ***Matter of Brussel***, Tax Appeals Tribunal, June 25, 1992).

M. With respect to petitioner's dormant Commerce Clause claim, the Tribunal also determined in ***Matter of International Bus. Mach. Corp.*** and ***Matter of Disney*** that the Division's interpretation of Tax Law former § 208 (9) (o) (3) as applied therein did not discriminate against foreign commerce and thus did not violate the dormant Commerce Clause. In reaching this conclusion, the Tribunal followed the principle of taking the "whole scheme of taxation into account" (***International Bus. Mach. Corp.***, citing ***Halliburton Oil Well Cementing Co. v Reily***, 373 US 64, 69 [1963]). The Tribunal further noted that case law defines dormant Commerce Clause discrimination in terms of economic interests, as opposed to the interests of taxable entities (***International Bus. Mach. Corp.***, citing ***Oregon Waste Sys., Inc. v Dept of Envtl. Quality of Oregon***, 511 US 93, 99 [1994] and ***New Energy Co. of Indiana v Limbach***, 486 US 269, 273 [1988]). The Tribunal also observed that the income exclusion and the expense add back provision apply only in the context of related member transactions and that related members, by definition, share the same economic interest. The Tribunal considered the impact of both the income exclusion and the expense add back components of Tax Law former § 208 (9) (o) on the shared economic interests of petitioners in ***International Bus. Mach. Corp.***, and ***Disney*** and their related member alien affiliates. In both those cases, the Tribunal concluded that Tax Law former § 208 (9) (o) (3) as applied did not violate the dormant Commerce Clause.

In the present matter, petitioner cites ***Kraft General Foods, Inc. v Iowa Dept. of Revenue and Fin.***, 505 US 71 [1992]; ***Westinghouse Elec. Corp. v Tully***, 466 US 388 [1984]; and ***Boston Stock Exch. v State Tax Commn.***, 429 US 318 [1977]) in support of its dormant Commerce Clause claim. The Tribunal has already found that these same cases are distinguishable:

> "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 entity is always offset by the cost of an expense add back to another related entity" (***Matter of Disney***).

In ***Matter of International Bus. Mach. Corp.,*** the petitioner cited ***Kraft General Foods, Inc. v Iowa Dept. of Revenue and Fin.*** in support of its dormant Commerce Clause claim. In ***Kraft***, an Iowa law that allowed a deduction for dividends received from domestic subsidiaries, but not for dividends received from foreign subsidiaries, was determined to discriminate against foreign commerce and thereby violate the Commerce Clause. In ***International Bus. Mach. Corp.***, the Tribunal concluded that ***Kraft*** is distinguishable. The Tribunal found that:

> "[s]pecifically, in contrast to the unequal treatment of the two groups in ***Kraft***, the overall impact of Tax Law former § 208 (9) (o) is to impose a similar ENI burden on the shared economic interests of related members, whether or not the royalty payer is also a taxpayer."

The Tribunal also noted its explanation in ***Disney***:

> "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 the tax directly, while its similarly situated counterpart pays the tax indirectly through its controlling interest in its related member."

As noted, the Tribunal in both ***Disney*** and ***International Bus. Mach. Corp.***, determined Tax Law former § 208 (9) (o) (3) as applied did not violate the dormant Commerce Clause. Accordingly, petitioner's dormant Commerce Clause claim is rejected.

N. Petitioner claims that denying an exclusion for royalty income that it received from its foreign related members is improper and violates the Equal Protection Clause of the United States Constitution and Article 1 § 11 of the New York State Constitution. Petitioner further claims that the denial of the exclusion based upon "the corporate states of residence" of the payers is discriminatory and "places greater burdens on taxpayers doing business with foreign corporations than those doing business with New York corporations."

"The Equal Protection Clause 'imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of State taxation'" (***Port Jefferson Health Care Facility v Wing***, 94 NY2d 284, 290 [1999], quoting ***Allied Stores v Bowers***, 358 US 522, 526-527 [1959]). "[T]he equal protection clause does not prevent State Legislatures from drawing lines that treat one class of individuals or entities differently from others unless the difference in treatment is palpably arbitrary or amounts to an invidious discrimination" (***Matter of Karlsberg v Tax Appeals Trib. of State of N.Y.***, 85 AD3d 1347 [3d Dept 2011], ***appeal dismissed*** 17 NY3d 900 [2011], quoting ***Trump v Chu***, 65 NY2d 20, 25 [1985], ***appeal dismissed*** 474 US 915 [1985] [internal quotation marks omitted]).[5] Petitioner's equal protection arguments are rejected. Petitioner has offered no evidence that it was treated any differently than other taxpayers, similarly situated, in the application of Tax Law former § 208 (9) (o) (3).

O. Petitioner argues that New York's royalty exclusion as applied to it is unconstitutionally discriminatory in violation of the Commerce Clause. Petitioner further argues that such discrimination causes a deprivation of property on it without due process of law and, therefore, violates the Due Process Clause. Since Tax Law former § 208 (9) (o) (3) as applied does not violate the dormant Commerce Clause (***see*** conclusion of law M), petitioner's Due Process claim is rejected.

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[5] The review of any differences in taxation is the same under both Federal and State Constitutions and "'is subject to the lowest level of judicial review, whether any rational basis supports the legislative choices'" (***Matter of DaimlerChrysler Co., LLC v Billet***, 51 AD3d 1284, 1287 [3d Dept 2008], quoting ***Port Jefferson Health Care Facility v Wing***, 94 NY2d at 289).

P. Petitioner also asserts that its royalty payments must be included in the computation of its business allocation percentage regardless of whether they are deducted from the ENI base pursuant to Tax Law former § 208 (9) (o) (3). Although it has been concluded in the above findings that petitioner is not entitled to exclude royalties received from foreign affiliates in the computation of its entire net income, to provide a complete record for consideration on appeal the issue is addressed below.

During the years at issue, New York corporate taxpayers reported their tax liability as the greatest amount due as computed by four different methods or bases, one of which was their ENI base (***see*** Tax Law former § 201 [1] [a-d]). ENI is generally the same as the taxpayer's entire federal taxable income (FTI) with certain, statutorily specified, modifications:

> "the term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income), (i) which the taxpayer is required to report to the United States treasury department. . . ." (Tax Law former § 208 [9]).

FTI is the starting point in computing ENI, subject to the addition and subtraction modifications set forth in Tax Law former § 208 (9) (a) and (b) (20 NYCRR 3-2.2 [b]). Pursuant to Tax Law former § 208 (9) (a) (17), ENI shall not include the amount deductible under Tax Law former § 208 (9) (o). Royalty payments properly deductible pursuant to Tax Law former § 208 (9) (o) (3) are not includible in ENI.

Business receipts, for purposes of the receipts factor of the business allocation percentage, means "gross income received in the regular course of the taxpayer's business, provided such receipts are includible in the taxpayer's entire net income for the taxable year" (20 NYCRR 4.4.1 [a]; ***see Matter of CS Integrated, LLC***, Tax Appeals Tribunal, November 20, 2003, ***confirmed Matter of CS Integrated, LLC v Tax Appeals Trib.***, 19 AD3d 886 [3d Dept 2005]).

Since royalty payments deductible under Tax Law former § 208 (9) (o) (3) are not included in ENI, the receipts from such royalty payments are not business receipts for purposes of the receipts factor. If petitioner may deduct the royalties it received from alien affiliates, i.e., Genzyme Ireland Ltd. and Genzyme Global S.a.r.l, those receipts are not included in the denominator of its receipts factor of its business allocation percentage.

Q. On November 17, 2015, the Division issued the Notice that asserted additional corporation franchise tax and MTA surcharge due in the amount of $609,231.00, interest due of $298,748.30, penalties of $60,919.00, and credits in the amount of $408,887.00 for the period January 1, 2004 through December 31, 2010 (***see*** finding of fact 29). The Notice also denied petitioner's claims for refund for the years ending 2005 through 2010 (***id.***). Petitioner has since agreed to the Division's audit adjustments included in the Notice, but for the Division's denial of the deduction of royalty income received from alien affiliates in computing its entire net income (***see*** finding of fact 32). The Division has also agreed to abate all penalties asserted in the Notice (***id.***). Based upon the foregoing, it is concluded that petitioner cannot deduct the royalty payments Genzyme and GTPLP received from Genzyme Ireland Ltd. and Genzyme S.a.r.l. in computing its ENI for the years ending 2005 through 2010. Therefore, the Division's denial of petitioner's claims for refund for the years ending 2005 through 2010 was proper. Because the royalty payments cannot be deducted from petitioner's federal taxable income in computing its entire net income and are included in the denominator of petitioner's receipts factor of its business allocation percentage, petitioner is not entitled to any refund and is liable for additional tax in the amount of $200,344.00, plus statutory interest as reflected in the Notice (***see*** finding of fact 34).

R. The petition of Genzyme Corporation is granted in accordance with conclusion of law Q, but in all other respects is denied; the Division's denial of petitioner's refund claims is sustained and the notice of deficiency, dated November 17, 2015, as modified in accordance with conclusion of law Q, is hereby sustained.

DATED: Albany, New York
April 7, 2022

/s/ Winifred M. Maloney .
ADMINISTRATIVE LAW JUDGE

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