

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition
of
**KIMBERLY-CLARK CORPORATION
AND COMBINED AFFILIATES**
for Redetermination of a Deficiency or for Refund
of Corporation Franchise Tax under Article 9-A of the
Tax Law for the Tax Periods January 1, 2009 through
December 31, 2012.

DETERMINATION
DTA NO. 828259

Petitioner, Kimberly-Clark Corporation and Combined Affiliates, filed a petition for redetermination of a deficiency or for the refund of corporation franchise tax under article 9-A of the Tax Law for the tax periods January 1, 2009 through December 31, 2012.

A hearing was held in New York, New York, on August 20, 2019, and continued in Albany, New York, on February 5, 2020, with all briefs to be submitted by October 19, 2020, which date began the six-month period for issuance of this determination. Petitioner appeared by Pillsbury Winthrop Shaw Pittman, LLP (Marc A. Simonetti, Esq., and Evan M. Hamme, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Jennifer L. Baldwin, Esq., of counsel). After reviewing the entire record in this matter, Nicholas A. Behuniak, 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 pursuant to Tax Law former § 208 (9) (o).

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

III. Whether the receipt of prepaid royalties may qualify for the exclusion for royalties received from foreign affiliates in the year the prepayments were made.

FINDINGS OF FACT

The parties executed a stipulation of facts, dated August 13, 2019, in connection with this matter. Such stipulated facts have been substantially incorporated into the findings of fact set forth herein except for stipulated fact 36 which is not necessary. In addition, petitioner, Kimberly-Clark Corporation and Combined Affiliates, submitted 74 proposed findings of fact. Petitioner's proposed findings of fact 1, 2, 11 through 13, 15, 16, 19 through 23, 27, 39 through 41, 44, 45, 48, 49, 50, 54 through 58, 62 through 65, 67 through 72 and 74 are accepted and have been substantially incorporated into the findings of fact. Proposed findings of fact (or material parts thereof) 3, 4, 5, 7, 8, 10, 18, 24, 25, 30, 43, 53 and 73 are not supported by the record cited to by petitioner, or the citations provided are insufficiently precise to verify the accuracy of the assertions made therein. Proposed findings of fact 6, 9, 14, 17, 26, 28, 42, 46, 47, 51, 52, 61 and 66 are rejected as irrelevant and/or redundant given the facts already found. Proposed findings of fact 29 and 35 are rejected as conclusory and relate to matters of law. Proposed findings of fact 31 through 34, 36 through 38, 59 and 60 are rejected as irrelevant, immaterial and/or take testimony out of context of the entire record.¹

¹ Petitioner submitted a post-hearing errata sheet listing proposed corrections or modifications to the transcripts of proceedings held herein. The Division of Taxation had no objection to the proposed corrections and modifications; the petitioner's proposed corrections or modifications are adopted as set forth on the errata sheet that has been appended to the transcripts of proceedings. In addition, the undersigned notes that the transcript for the hearing held on February 4, 2020, included several hyphens throughout and such hyphens should have been recognized in the transcript as "coughs" (*see* 20 NYCRR 3000.15 [d] [7]).

1. Petitioner, Kimberly-Clark Corporation and Combined Affiliates, is a group of affiliated corporations, including all such affiliated corporations incorporated in the United States, which produce and sell a wide range of consumer products, under brand names such as Kleenex, Huggies, Depend and Kotex, and license to others, both related and unrelated, the intellectual property rights used to produce and sell such products.

2. On petitioner's original New York State form CT-3-A, general business corporation combined franchise tax return, for the tax period ended December 31, 2009, petitioner subtracted \$0.00 on line 15, other subtractions.

3. On petitioner's amended New York State form CT-3-A for the tax period ended December 31, 2009, petitioner subtracted \$273,090,225.00 on line 15 other subtractions.

4. The \$273,090,225.00 on line 15 of its amended form CT-3-A for 2009 was included in the amount reported on line 7, gross royalties, of petitioner's federal form 1120 for 2009.

5. Of the total amount petitioner subtracted on line 15 of its amended form CT-3-A for 2009, \$259,649,019.00 represents royalty payments received by petitioner pursuant to intercompany license agreements (license agreements) whereby petitioner licenses certain property to non-United States affiliates of petitioner (alien affiliates). The alien affiliates were not members of petitioner's combined returns for the audit period.

6. Petitioner agrees that \$13,441,206.00 of the \$273,090,225.00 reported on line 15 of its amended form CT-3-A for 2009 should not have been subtracted. The remaining amount of \$259,649,019.00, is the amount that should have been reflected as royalty payments received for purposes of Tax Law § 208 (9) (o) for that year.

7. On petitioner's original New York State form CT-3-A, for 2010, petitioner subtracted \$0.00 on line 15, other subtractions.

8. On petitioner's amended New York State form CT-3-A, for 2010, petitioner subtracted \$312,846,041.00 on line 15, other subtractions.

9. The \$312,846,041.00, reported on line 15 of its amended form CT-3-A for 2010 was included in the amount reported on line 7, gross royalties, of petitioner's federal form 1120 for 2010.

10. Of the total amount petitioner subtracted on line 15 of its amended form CT-3-A for 2010, \$304,263,627.00, represents royalty payments received by petitioner pursuant to the license agreements.

11. Petitioner agrees that \$8,539,295.00 of the \$312,846,041.00, reported on line 15 of its amended form CT-3-A for 2010 should not have been subtracted. The remaining amount of \$304,263,627.00 is the amount that should have been reflected as royalty payments received for purposes of Tax Law § 208 (9) (o) for that year.

12. On petitioner's original New York State form CT-3-A, for 2011, petitioner subtracted \$0.00 on line 15, other subtractions.

13. On petitioner's amended New York State form CT-3-A for 2011, petitioner subtracted \$572,376,129.00 on line 15, other subtractions.

14. The \$572,376,129.00 reported on line 15 of its amended form CT-3-A for 2011 was included in the amount reported on line 7, gross royalties, of petitioner's federal form 1120 for 2011.

15. Of the total amount petitioner subtracted on line 15 of its amended form CT-3-A for 2011, \$559,376,481.00 represents royalty payments received by petitioner pursuant to the license agreements. These payments to petitioner under the license agreements are "royalty payments" for purposes of Tax Law § 208 (9) (o).

16. Petitioner agrees that \$12,999,648.00 of the \$572,376,129.00 reported on line 15 of its amended form CT-3-A for 2011 should not have been subtracted.

17. A portion of the remaining amount, \$63,412,102.00, represents prepayments of royalties for 2013. The \$63,412,102.00 of prepaid royalties from Kimberly-Clark Australia Pty. Ltd., which were reported in 2011 for federal income and New York State corporation franchise tax purposes, but were paid for the use of certain trademarks, patents, and know-how in 2013, is the only amount in dispute for 2011. The license agreement for these royalty payments allows for the prepayment of such.

18. On petitioner's original New York State form CT-3-A for 2012, petitioner subtracted \$229,887,657.00 on line 15, other subtractions.

19. The \$229,887,657.00 reported on line 15 of its original form CT-3-A for 2012 was included in the amount reported on line 7, gross royalties, of petitioner's federal form 1120 for 2012.

20. Of the total amount petitioner subtracted on line 15 of its original form CT-3-A for 2012, \$214,678,987.00 represents royalty payments received by petitioner pursuant to the license agreements.

21. Petitioner agrees that \$15,208,670.00 of the \$229,887,657.00 reported on line 15 of its amended form CT-3-A for 2012 should not have been subtracted. The remaining amount of \$214,678,987.00 is the amount that should have been reflected as royalty payments received for purposes of Tax Law § 208 (9) (o) for that year.

22. The relevant alien affiliates are not included in petitioner's federal consolidated income tax returns or New York State combined corporation franchise tax returns.

23. The alien affiliates did not file New York State tax returns for the periods at issue.

24. The alien affiliates are petitioner's "related members" for purposes of Tax Law § 208 (9) (o). The alien affiliates filed federal informational returns (federal forms 5471 and 8858) during the periods at issue. Whether the 2009, 2010, 2011 or 2012 payments to petitioner under the license agreements are "royalty payments" for purposes of Tax Law § 208 (9) (o) is not in dispute in this matter.

25. The Division of Taxation (Division) audited petitioner's amended forms CT-3-A and CT-3M/4M for 2009.

26. The Division audited petitioner's original and amended forms CT-3-A and CT-3M/4M for 2010, 2011 and 2012.

27. The Division determined that petitioner could not deduct the amounts reported on line 15, other subtractions, on its amended and original forms CT-3-A for the audit period. The Division in turn adjusted petitioner's business allocation percentage (BAP) to include such amounts in the denominator of the receipts factor.

28. The Division allowed other adjustments, unrelated to the amounts deducted on line 15, other subtractions, but also reflected on its amended forms CT-3-A and CT-3M/4M for 2009, 2010 and 2011, and allowed refunds in the amounts of \$871,679.00, \$1,045,352.00 and \$297,176.00 respectively. The Division issued a statement of tax reduction or overpayment, dated March 25, 2016, reflecting the changes to petitioner's 2009 New York State corporation franchise tax and Metropolitan Commuter Transportation District (MTA) surcharge, as described above. The Division issued a statement of tax reduction or overpayment, dated March 25, 2016, reflecting the changes to petitioner's 2010 New York State corporation franchise tax and MTA surcharge, as described above. The Division issued a statement of tax reduction or overpayment,

dated March 25, 2016, reflecting the changes to petitioner's 2011 New York State corporation franchise tax and MTA surcharge, as described above.

29. The Division denied the remainder of petitioner's refund request for 2009, 2010 and 2011 in the amounts of \$773,365.00, \$952,464.00, and \$1,412,295.00 respectively. The Division issued a notice of deficiency on February 24, 2016, reflecting additional corporation franchise tax and MTA surcharge, in the amount of \$615,357.00 for 2012, less payments/credits of \$615,357.00 of the amount of refund allowed for 2010, for a net amount due of \$0.00, i.e., the Division applied \$615,357.00 of the amount of refund allowed for 2010 against the deficiency of corporation franchise tax and MTA surcharge, determined as due in the amount of \$615,357.00 for 2012.

30. Any amounts determined to be subtracted in the calculation of entire net income, pursuant to Tax Law § 208 (9) (o), would likewise be subtracted from the denominator of the receipts factor of petitioner's BAP. Any amounts determined to be included in the calculation of entire net income would likewise be included in the denominator of the receipts factor of petitioner's BAP.

31. Petitioner filed a petition with the Division of Tax Appeals.

32. The Division timely filed an answer to the petition.

33. Under the license agreements, Kimberly-Clark Corp., and Kimberly-Clark Worldwide, Inc., licensed certain trademarks, patents and know-how to alien affiliates for the purpose of manufacturing and selling such products to consumers in specified territories for specified periods of time for varying percentages of the alien affiliates' profitability.

34. Kimberly-Clark Corp., and Kimberly-Clark Worldwide, Inc., also provided technical assistance as part of the license agreements. Any payments for such assistance were not

subtracted from combined entire net income on line 15, other subtractions, of petitioner's original or amended forms CT-3-A filed for the audit period.

35. Petitioner's amended and original forms CT-3-A and consolidated federal forms 1120 filed for the audit period include Kimberly-Clark Corp., and Kimberly-Clark Worldwide, Inc., which are incorporated in the United States.

36. During the audit, petitioner communicated to the Division that it excluded the subject alien affiliate royalties from its income pursuant to Tax Law § 208 (9) (o).

37. A hearing on this matter was scheduled to be conducted in New York City on August 20 and 21, 2019.

38. The first day of the hearing was conducted in New York City on August 20, 2019.

39. Ms. Deborah Liebman, Deputy Counsel for the Division, failed to appear at the first day of the hearing although petitioner represented it had issued a subpoena seeking her attendance for the hearing and if necessary would seek a court order requiring her attendance at the continued hearing for this matter.

40. The August 2019 hearing was continued to allow for the testimony of Ms. Liebman.

41. The continued hearing in this matter was held in Albany, New York, on February 5, 2020. Ms. Liebman testified at the continued hearing.

SUMMARY OF THE PARTIES' POSITIONS

42. The Division asserts that pursuant to Tax Law former § 208 (9) (o), petitioner, a New York State taxpayer, may not exclude royalties received from foreign alien affiliates in the computation of its entire net income when the alien affiliates paying the royalties are not New York State taxpayers. At the hearing, the Division's auditor only mentioned this reason for the Division's adjustment to petitioner's returns. The Division asserts its approach is legal under the

United States Constitution. In the Division's opening statement at the hearing, the Division also asserted that petitioner cannot account for prepaid royalties in one year and potentially take advantage of their favorable tax treatment in that year, when in fact such royalties are earned in a subsequent year when the favorable tax treatment provisions are no longer available. The stipulation of facts agreed to by the parties reflects that accounting for the prepaid royalties was a potential issue.

43. Petitioner asserts that the royalties received by petitioner, a New York State taxpayer, from foreign alien affiliates may be excluded from petitioner's income regardless of whether the alien affiliates are New York taxpayers. Petitioner asserts the Division's approach violates the dormant Commerce Clause of the United States Constitution. Petitioner also asserts that it is an accrual basis taxpayer and the subject license agreements permit prepayment of royalties, and petitioner may properly take advantage of tax benefits of prepaid royalty payments in the year such payments are received.

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 within the MTA 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]). 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 BAP (*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. Tax Law former § 208 (9) (o) (3), the royalty income exclusion, was a subtraction modification to ENI that provided:

“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).

Tax Law former § 208 (9) (o) (2), referenced above, is the royalty expense add back, an addition modification that 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. Petitioner does not assert any of these exceptions apply in this case.

D. 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 Intl. 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 (*Intl. Bus. Mach. Corp.*, citing *Matter of Charter Dev. Co., L.L.C. v City of Buffalo*, 6 NY3d 578, 582 [2006]).

E. 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” (*Intl. 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]” (*Intl. 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]).

F. In this case, petitioner and its alien affiliates were related members for purposes of Tax Law former § 208 (9) (o) (3) (*see* finding of fact 24). 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.

G. 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 related 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 *Intl. 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 *Intl. 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 *Intl. 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 on 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 *Intl. 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 *Intl. Bus. Mach. Corp.*, stated its interpretation of Tax Law former § 208 (9) (o) (3) "draws no inference from the 2013 repeal of that provision" (*Intl. Bus. Mach. Corp.*, citing *Disney* and L 2013 ch 59). In both *Disney* and *Intl. 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. The Tribunal also determined in *Intl. Bus. Mach. Corp.*, and *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” (*Intl. 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 (*Intl. Bus. Mach. Corp.*, citing *Oregon Waste Sys., Inc. v Dept. of Env'tl. 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 interest of petitioners in *Intl. Bus. Mach. Corp.*, and *Disney* and their related member alien affiliates. In both of those cases the Tribunal concluded that Tax Law former § 208 (9) (o) (3) as applied did not violate the dormant Commerce Clause.

L. Petitioner claims the Tribunal’s interpretation of the royalty income exclusion and its constitutional analysis in *Disney* is “unreasonable” and “fundamentally flawed.”² Petitioner does not assert that the facts in this case are materially different from the facts in *Disney* nor does petitioner offer any materially different legal arguments from what was argued in *Disney*. 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 *Intl. Bus. Mach. Corp.* As noted, in both *Disney* and *Intl. 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

² The Tribunal’s *Intl. Bus. Mach. Corp.*, decision had not been issued yet at the time petitioner filed its last brief in this matter, but presumably petitioner would have leveled the same criticisms with the analysis in that decision as it had to the analysis made in the *Disney* decision.

affiliates paying the royalties are not New York State taxpayers. As also noted, the Tribunal in both *Disney* and *Intl. Bus. Mach. Corp.*, determined that this approach is constitutional.

M. Accordingly, petitioner's arguments about the interpretation of the royalty income exclusion and the constitutionality of the Division's position are rejected.

Prepaid Royalties

N. The Division also asserts that petitioner cannot account for prepay royalties in one year and potentially take advantage of their favorable tax treatment in that year, when such royalties are earned in a subsequent year when the favorable tax treatment provisions are no longer available. In the case at hand, petitioner received prepaid royalties from an alien affiliate in 2011, a year when the potential favorable tax benefits of Tax Law former § 208 (9) (o) (3) were still in effect. However, the 2011 prepaid royalties were not actually earned until 2013, which, as noted above, is a year in which the royalty income exclusion favorable tax treatment was no longer available. In this regard the Division, citing to the Tribunal's analysis in *Disney*, asserts that petitioner bears the burden to overcome the asserted deficiency including establishing the accuracy of the amount it seeks to exclude from its ENI as royalty payments. The Division goes on to argue that petitioner has not proven that it should be allowed to deduct royalty payments for the use of intangible property in a year there is no deduction for royalty payments received from related members and petitioner should not be allowed to circumvent the repeal of Tax Law former § 208 (9) (o) (3) by prepaying such royalties. The Division provides no additional authority for its assertions on this issue.

Because of the findings above, this issue has no impact on the final tax amounts determined herein; however, to provide a complete record for consideration on appeal the issue is addressed below.

The starting point in the analysis of this issue is that the parties had already stipulated that the payments at issue are for royalties (*see* finding of fact 17). The parties also stipulated that the subject license agreement permitted the prepayment of royalty amounts (*id.*). There appears to be no question that the payments were made and that they were in fact royalty payments. The royalty income exclusion provision of the Tax Law permits taxpayers to exclude from entire net income royalties received from a related member during the taxable year to the extent included in the taxpayer's federal taxable income (*see* Tax Law former § 208 [9] [o] [3]). In its reply brief, petitioner asserts that it files its tax returns on an accrual basis and the payments were made pursuant to the terms of the licensing agreement and thus accounting for the royalties in 2011 was appropriate. Whether petitioner files on a cash basis or accrual basis appears to be irrelevant. The tax court has held that Internal Revenue Code § 451 (a) requires:

“taxpayers to include items in gross income for the year they were received, unless, under the taxpayer's method of accounting, the amount is properly accounted for in a different period. A cash method taxpayer reports income when it is actually or constructively received. Sec. 1.451-1(a), Income Tax Regs. An accrual method taxpayer recognizes income when ‘all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.’ Sec. 1.446-1(c)(1)(ii), Income Tax Regs. Generally, under the ‘all events’ test accrual method taxpayers recognize income when it is paid, due, or earned, whichever occurs first” (*Joyner Family Ltd. Partnership v Commr.*, T.C. Memo 2019-159, 2019 WL 6726468, *9 [2019], citing *Schlude v Commr.*, 372 U.S. 128, 133 n.6 [1963]).

Generally, New York follows federal law regarding the year that income is recognized for tax purposes (*see* Tax Law former § 208 [9] [i]). Accordingly, it is concluded that petitioner appropriately accounted for the 2013 prepaid royalties it received in 2011 as income on its 2011 federal and New York State tax returns and such royalties could qualify for the exclusion of royalties received from foreign affiliates in 2011, the year the prepayments were made.

O. The petition of Kimberly-Clark Corporation and Combined Affiliates is denied; the statements of tax reduction or overpayment, dated March 25, 2016, for 2009, 2010 and 2011, and the notice of deficiency, dated February 24, 2016, are sustained.

DATED: Albany, New York
April 15, 2021

/s/ Nicholas A. Behuniak
ADMINISTRATIVE LAW JUDGE