REDACTED DECISION – DOCKET #S 06-544 N & 06-545 FN – BY ROBERT W. KIEFER, JR., ALJ – SUBMITTED FOR DECISION on MARCH 13, 2009 – ISSUED on JANUARY 6, 2010.

SYNOPSIS

BUSINESS FRANCHISE TAX – DUE PROCESS CLAUSE – As applied to the Petitioner, who licenses trademarks and trade names to others, including affiliated companies, who then sell trademarked and trade-named products to customers in West Virginia, the West Virginia business franchise tax, W. Va. Code § 11-23-1, *et seq*., does not violate the Due Process Clause of the United States Constitution, *U. S. Const. amend XIV, § 1*, because the Petitioner has minimum contacts with the State of West Virginia and the tax is rationally related to values connected with the taxing State.

BUSINESS FRANCHISE TAX – COMMERCE CLAUSE – As applied to the Petitioner, who licenses trademarks and trade names to others, including affiliated companies, who then sell trademarked and trade-named products to customers in West Virginia, the West Virginia business franchise tax, W. Va. Code § 11-23-1, *et seq*., does not violate the Commerce Clause of the United States Constitution, *U. S. Const. art 1, § 8, cl. 3*., because: 1) The Petitioner has a substantial nexus with the State of West Virginia; 2) the tax is fairly apportioned to the State of West Virginia; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the benefits provided by the State.

CORPORATION NET INCOME TAX – DUE PROCESS CLAUSE – As applied to the Petitioner, who licenses trademarks and trade names to others, including affiliated companies, who then sell trademarked and trade-named products to customers in West Virginia, the West Virginia corporation net income tax, W. Va. Code § 11-24-1, *et seq*., does not violate the Due Process Clause of the United States Constitution, *U. S. Const. amend XIV, § 1*, because the Petitioner has minimum contacts with the State of West Virginia and the tax is rationally related to values connected with the taxing State.

CORPORATION NET INCOME TAX – COMMERCE CLAUSE – As applied to the Petitioner, who licenses trademarks and trade names to others, including affiliated companies, who then sell trademarked and trade-named products to customers in West Virginia, the West Virginia corporation net income tax, W. Va. Code § 11-24-1, *et seq*., does not violate the Commerce Clause of the United States Constitution, *U. S. Const. art 1, § 8, cl. 3*., because: 1) The Petitioner has a substantial nexus with the State of West Virginia; 2) the tax is fairly apportioned to the State of West Virginia; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the benefits provided by the State.

FINAL DECISION

An auditor with the Multistate Tax Commission conducted an audit of the books and records of the Petitioner. Thereafter, on July 31, 2006, the Director of the Field Auditing Division of the State Tax Commissioner's Office issued a corporation net income tax assessment against the Petitioner. The assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 24 of the West Virginia Code. The assessment was for the period of June 1, 2000, through May 31, 2003, for tax in the amount of $____ and interest in the amount of $____, computed through August 31, 2006, for a total assessed tax liability of $____.

Also, on July 31, 2006, the Commissioner (by the Division) issued a business franchise tax assessment against the Petitioner, under the provisions of Chapter 11, Articles 10 and 23 of the West Virginia Code, for the year period of period of June 1, 2000, through May 31, 2003, for tax in the amount of $____, and interest in the amount of $____, computed through August 31, 2006, for a total assessed tax liability of $____.

Written notice of both assessments was served on the Petitioner on August 3, 2006.

Thereafter, by mail postmarked September 29, 2006, received in the offices of the West Virginia Office of Tax Appeals on October 2, 2006, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. W. Va. Code §§ 11-10A-8(1) [2007] and 11-10A-9 [2005].

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

FINDINGS OF FACT

I. STIPULATED FACTS[1]

1. Corporation A, a Nebraska corporation, is a wholly-owned subsidiary of Corporation B.

2. On January 2, 1997, Corporation B. entered into an agreement with Corporation A, whereby Corporation B transferred its trademarks to Corporation A. A copy of the agreement has been identified as Exhibit "A".

3. On January 2, 1997, Corporation A entered into an agreement with Corporation B whereby Corporation B agreed to pay royalties to Corporation A for use of the trademarks transferred by Corporation B to Corporation A, which trademarks are identified in the agreement as Exhibit "A" attached thereto. A copy of this agreement has been identified as Exhibit "B".

4. Beginning on January 2, 1997, other affiliates of Corporation B transferred their trademarks to Corporation A by written agreements. Copies of these agreements have been identified collectively as Exhibit C.

5. Beginning on January 2, 1997, Corporation A entered into agreements with other affiliates of Corporation B, whereby the affiliates agreed to pay royalties to Corporation A for use of the trademarks transferred by the agreements marked as Exhibit "C." Copies of these agreements have been identified collectively as Exhibit "D".

6. Beginning on January 2, 1997, Corporation A acquired trademarks and tradenames from unrelated entities. Copies of these agreements have been identified collectively as Exhibit "E".

7. Corporation A also licensed its trademarks and tradenames to unrelated third parties. Copies of these agreements have been identified collectively as Exhibit "F".

8. Corporation A pays all expenses in connection with the use of the trademarks and tradenames including defending its trademarks and tradenames against infringement and

[1] The facts stipulated by the parties are reproduced here verbatim.

directing and overseeing the national marketing by developing marketing strategies and purchasing the placement of advertisements with national media outlets.

9. Corporation A derived its income from the royalty payments it receives from various licensees for their use of its trademarks and tradenames including Corporation B, subsidiaries of Corporation B and unrelated third parties.

10. Prior to the creation of Corporation A, Corporation B and the other subsidiaries of Corporation B incurred and paid the expenses associated with the use of their trademarks and tradenames.

11. Corporation B and affiliates deduct the royalties paid to Corporation A from gross income as an expense when determining their taxable income for state tax purposes.

12. To exercise their rights pursuant to their license agreements, the Licensees first affix the trademarks and tradenames, licensed to them by Corporation A, to products the Licensees manufacture in facilities located outside the State of West Virginia.

13. The Licensees distributed their products bearing the licensed trademarks and tradenames in West Virginia and throughout the United States.

14. The Licensees sold or distributed products bearing the licensed trademarks and tradenames, and other merchandise, to wholesalers and retailers located in West Virginia.

15. The Licensees provided services to their clients and customers in West Virginia.

16. Corporation A did not maintain any inventory of merchandise or material for sale, distribution or manufacture in West Virginia.

17. Corporation A did not sell or distribute merchandise to its Licensees, their customers or any other business entity in West Virginia.

18. Corporation A did not provide any services to its Licensees, their customers or any other business entity in West Virginia.

19. Corporation A did not have any employees or agents in West Virginia.

20. Corporation A did not own or rent any offices, warehouses or other such facilities at locations in West Virginia.

21. Corporation A did not direct and/or dictates (sic) how the Licensees distribute the products bearing the licensed trademarks or tradenames.

II. ADDITIONAL FINDINGS OF FACT

22. Corporation A was created to centrally manage and provide for uniformity in brand image and brand presentation for the highly valued trademarks and tradenames used by Corporation B and its subsidiaries.

23. Prior to the creation of Corporation A, Corporation B and its subsidiaries operated as independent operating companies, which made it difficult to maintain a uniform brand image and thereby protect the value of the various trademarks and tradenames.

24. For example, according to the testimony of the Senior Director – Tax at Corporation B, prior to the formation of Corporation A, the valuable meat product trademark, that was synonymous with high-quality, moist and flavorful turkey products, was being used on lower-quality chicken products which jeopardized the value that had been created for the valuable meat product trademark.

25. Due to the use of trademarks by multiple independent operating companies, the management of the marks was inconsistent, disjointed, and inefficient. In many instances, as cited in the valuable meat product trademark example, the value of the various marks was damaged by the uncontrolled use of the trademarks by certain independent operating companies.

26. Corporation A was also formed to prevent such occurrences in the future, and to protect the intellectual property from infringement by third parties.

27. Upon formation, Corporation A received royalties for the use of its tradenames on products manufactured by certain affiliated licenses as well as from unrelated third-part licensees, together referred to as ("Licensees"), using processes that ensured certain quality and taste in the finished, salable food products.

28. Beginning on January 2, 1997, Corporation B and its affiliates began transferring their trademarks to Corporation A., a wholly-owned subsidiary. See Exhibit "A".

29. In exchange for the trademarks conveyed, Corporation B and affiliates received no apparent consideration in the form of cash, assets or their equivalent from Corporation A. See Exhibit "A."

30. Despite receiving no apparent consideration for the trademarks conveyed to the Petitioner, Corporation B and affiliates agreed to pay royalties to the Petitioner for use of the trademarks they previously owned. See Exhibit "B".

31. The impact on taxes was given consideration in the formation of Corporation A.

32. The royalties paid by the Petitioner's licensees to it were calculated, in large measure, as a percentage of the licensees' sales.

33. As a result of this transaction, Corporation B and its affiliates are able to deduct the royalty expenses from their income, thereby substantially reducing their taxable incomes.

34. Corporation A has ceased doing business.

35. All manufacturing processes utilized by Licensees to produce and to ensure the quality and taste of the finished products occurred at Licensees' manufacturing facilities located outside of West Virginia.

36. Because it was of the opinion that it had no connection with West Virginia, Corporation A did not file income tax returns with the State in any year.

37. In 2006, Corporation A was audited for the periods from June 1, 2000 to May 31, 2003.

38. The auditor for the Multistate Tax Commission ("MTC") based the assessment on his conclusion that Corporation A was subject to West Virginia corporate net income tax and business franchise tax for income derived from the Licensees' sales of products in West Virginia during these periods.

DISCUSSION

This matter involves taxation of a company that is the owner of trademarks and trade names that it licenses to others. The Petitioner's licensees market and sell the trademarked and trade-named products in the United States and its territories, including West Virginia. The State Tax Commissioner seeks to tax the apportioned share of the Petitioner's net income and the apportioned share of its business capital. The Petitioner challenges the State Tax Commissioner's authority to levy the tax, asserting that the Commissioner is prohibited from doing so by two provisions of the United States Constitution. Specifically, the Petitioner contends that said net income is not subject to taxation by reason of the Due Process Clause of the United States Constitution, *U. S. Const. amend XIV, § 1*, and the Commerce Clause of the United States Constitution *U. S. Const. art 1, § 8, cl. 3*.

DUE PROCESS CLAUSE

The Due Process Clause of the United States Constitution requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and that the "income attributed to the state for tax purposes must be rationally related to values connected with the taxing State." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306, 112 S. Ct. 1904, 1909-10, 119 L. Ed. 2d 91, 102 (1992). This minimum connection may be satisfied even where the taxpayer has no physical presence within the state to which it purposefully directs economic activity. *Id*. at 308, 112 S. Ct. at 1911, 119 L. Ed. at 104.

In analyzing the first portion of this due process standard, a number of courts have held that the licensing of trade names or trademarks to third parties who use the trade names or trademarks in the taxing state satisfies the minimum contacts requirement of the Due Process Clause.

In *Geoffrey, Inc. v. S. C. Tax Commission*, 313 S.C. 15, 437 S.E.2d 13 (1993) (*"Geoffrey (S.C.)")*[2], the taxpayer was in the business of owning, licensing and managing trademarks for its own economic benefit. The Supreme Court of South Carolina determined the normal course of the licensor's business contemplated and purposefully sought the benefits of economic contact with the states in which the trade names and trademarks were used; that was its business. The licensor argued that because its licensee had no stores in South Carolina at the time that the parties entered into the licensing agreement, the licensor did not purposefully direct its economic activity at South Carolina's economic forum. However, the licensor knew that the licensee was not contractually prohibited from doing so at a later date. The licensor knew that it would benefit from the licensee's future direction of its activities towards South Carolina economic forum. If the licensor had wished to avoid contact with the State of South Carolina, it could have contractually prohibited the licensee from using its trade names and trademarks in South Carolina. By failing to do so, it purposefully directed its activities toward the South Carolina economic market. *Id*. at 19, 437 S.E.2d at 16. Therefore, the licensor was not unwillingly brought into contact with South Carolina through the unilateral activity of an unrelated party. *Id*. at 19, 437 S.E.2d at 16. *See also Geoffrey, Inc. v. Oklahoma Tax Comm.*, 132 P.3d 632 (Okla. Ct. Civ. App. 2006) (*"Geoffrey (Okla.)")*; Arizona Dept. of Revenue, Case No. 200700083-C (March 27, 2008) (By licensing trademarks, trade names, manuals and software to franchisees in

[2] The numerous cases involving Geoffrey, Inc. requires differentiating among the decisions by identifying each by the state where the case was decided.

Arizona and receiving royalties based on franchisees' gross receipts, franchisor purposefully sought benefit of economic contact with Arizona).

The Supreme Court of South Carolina also held that the minimum contacts requirement was satisfied by the presence of the taxpayer's property, specifically intangible property, in the South Carolina. Since the right afforded by the intangible property is exercised in the State, its situs is in the State. *Geoffrey (S.C.)*, 313 S.C. at 21-22, 437 S.E.2d at 17. *See also Secretary, Dept. of Rev., St. of La. v. Gap (Apparel), Inc.*, 886 So.2d 459, 462 (2004) (Intangible property used in state other than that of legal domicile so as to become an integral part of a business carried on in that state acquires a "business situs" in the state in which it is used and is subject to taxation in that state); *American Dairy Queen Corp. v. Tax & Rev. Dept.*, 93 N.M. 743, 605 P.2d 251 (N. M. Ct. App. 1979) (A principal part of the franchisor's business is leasing a bundle of intangible property rights, including trademarks, trade name, business practices and certain patent rights, which are employed in New Mexico).

Based on these decisions, this tribunal has no problem holding that the Petitioner has the requisite minimum contacts with the State of West Virginia necessary to satisfy the Due Process Clause. It licenses its trademarks and trade names to other persons and entities that manufacture goods bearing those trademarks and trade names and then sell the goods in the State of West Virginia. The Petitioner receives royalty payments from the licensees, primarily based on the amount of sales. Thus, it benefits from the sale of its licensed products in the State of West Virginia. Therefore, the Petitioner has availed itself of the economic forum of the State of West Virginia.

The Petitioner does not contend that it does not anticipate the sale of its licensed products into the State of West Virginia. In fact, the Petitioner's licensing contracts anticipate that its licensees will sell licensed products in all the states in the Union. The Petitioner claims that it has less that the requisite minimum contacts with this State because only its licensees have contact with this State. However, consistent with the cases cited above, the Petitioner has purposefully availed itself of the economic forum of the State of West Virginia. Thus, the Petitioner has the constitutional due process requirement of minimum contacts with the State of West Virginia.

With respect to the second part of the due process test, courts have held that the states have conferred benefits to which the tax is rationally related, when the tax was imposed on taxpayers who licensed trademarks to licensees located in or doing business in the state seeking to impose the tax.

In *Geoffrey (S.C.), supra*, the court held that the real source of the licensor's income is not the agreement, but the licensee's customers. By providing an orderly society, the State of South Carolina made it possible for South Carolinians to purchase licensed goods, resulting in income to the licensor. Therefore, the income sought to be taxed was rationally related to the benefits conferred upon the licensor. *Id.* at 22, 437 S.E.2d at 18.

In *KMart Properties, Inc. v. Taxation and Revenue Dept.*, 139 N.M. 177, 131 P.3d 27 (N.M. Ct. App. 2001), KMart Properties contended that it did not have minimum contacts with the State of New Mexico because it conducted all of its business in Michigan and had no personnel or property in New Mexico. The Court concluded that KMart Properties ignored the substance of its licensing agreement, which gave KMart Properties an interest in the revenue stream of every KMart store, tying it to every state where KMart Corporation had a store. KMart Properties had a direct pecuniary interest in New Mexico's consumer market, and purposefully availed itself of the benefits of the economic market of New Mexico. The Court noted that this should come as no surprise, since New Mexico had long held that the Due Process Clause allows taxation of a corporation that allows intangible trademarks to be used in New Mexico. *Id*. at 183, 131 P.3d 33. *See also Aamco Transmissions v. Tax & Rev. Dept.*, 93 N.M. 389, 392, 600 P.2d 841, 844 (N. M. Ct. App. 1979) (Franchisor has substantial monetary interest in good will and economic health of franchisee's businesses, which are protected and benefited by New Mexico laws. This provides a direct benefit to the franchisor, through its collection of royalties); Arizona Dept. of Revenue, Case No. 200700083-C (March 27, 2008) (Arizona provides orderly society for franchisees, making it possible for franchisor to earn income pursuant to franchise agreement).

As with the minimum contacts test, the Petitioner in this action receives benefits from the State of West Virginia that are rationally related to the activity taxed. The Petitioner benefits from the sales made by its licensees in the State of West Virginia. The tax is levied on the royalties received by the Petitioner, which are based on sales by the Petitioner's licensees. Thus, the State has conferred a benefit that is rationally related to the activity taxed.

COMMERCE CLAUSE

With respect to the Commerce Clause of the United States Constitution, a tax will survive scrutiny so long as 1) there is a substantial nexus between the State and the activity that is sought to be taxed, 2) the tax is fairly apportioned, 3) the tax does not discriminate against interstate commerce, and 4) the tax is fairly related to the benefits provided by the State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 374, 97 S.Ct. 51, L.Ed.2d 326 (1977).

In *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), the United States Supreme Court upheld the requirement that a vendor must have a physical presence in a state before the state may require it to collect a sales or use tax, articulating the practical reasons for such a bright-line rule and relying on the doctrine of *stare decisis*. *Id*. at 310-18, 112 S. Ct. at 1912-16, 119 L. Ed. 2d at 105-10. The Court noted that it had not adopted such a physical presence requirement in cases involving other types of taxes. *Id*. at 317-18, 112

S. Ct. at 1916, 119 L. Ed. 2d at 110. Although it has been the subject of considerable litigation since the decision in *Quill*, it appears that the substantial nexus of the *Complete Auto* test does not require a physical presence, except in cases involving sales and use taxes.

As have most of the courts that have considered this issue, the Supreme Court of Appeals of West Virginia held that the physical presence requirement applies only when the State attempts to require vendors to collect the consumers sales and service tax and the purchasers use tax. It held that there is no constitutional requirement of physical presence applicable to the business franchise tax and corporation net income tax, the taxes that are under consideration in this matter. *Tax Commissioner v. MBNA Bank*, 220 W. Va. 163, 169, 640 S.E.2d 226, 232 (2006), *cert denied sub nom.*, *FIA Card Services, N.A. v. Tax Commissioner of West Virginia*, 551 U.S. 1147, 127 S. Ct. 2997, 168 L.Ed.2d 719 (2007). *See also Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 128 (La. Ct. App. 2008) ("*Geoffrey (La.)*"); *Geoffrey, Inc. v. Comm. of Revenue*, 453 Mass. 1, 15, 899 N.E.2d 76, 86 (2009) ("*Geoffrey (Mass.)*"); *Capital One Bank. v. Comm. of Revenue*, 453 Mass. 17, 23, 899 N.E.2d 87, 92 (2009); *Lanco, Inc. v. Division of Taxation*, 188 N.J. 380, 908 A.2d 176 (2006); *KMart Properties, Inc. v. Taxation and Revenue Dept.*, *supra* at 186, 131 P.3d at 36, *rev'd on other grounds*, *KMart Corporation v. Taxation and Revenue Dept.*, 139 N.M. 172, 186, 131 P.3d 22 (2001); *A&F Trademark, Inc. v. Tolson*, 167 N.C.App. 150, 162, 605 S.E.2d 187, 195 (2004); *Geoffrey (Okla.)*, 132 P.3d at 638-39; *Geoffrey (S.C.)*, 313 S.C. at 23, 437 S.E.2d at 18; and Arizona Dept. of Revenue, Case No. 200700083-C (March 27, 2008). It goes without saying this tribunal is bound by this holding of the West Virginia Supreme Court and cannot overrule it.

While the West Virginia Supreme Court did not have the opportunity to discuss the Commerce Clause implications of licensing trademarks used by the licensee in the taxing state, other courts have done so. In *KMart Properties, Inc. supra*, the New Mexico Court of Appeals held that "the use of [Kmart Properties Inc.'s] marks within New Mexico's economic market, for the purpose of generating substantial income for [Kmart Properties Inc.], establishes a sufficient nexus between that income and the legitimate interests of the state and justified the imposition of a state income tax." In the context of New Mexico's gross receipts tax,[3] the Court engaged in a particularly enlightening discussion respecting the true nature of trademark licensing contracts. It noted that it is a principle of trademark law that a trademark and the goodwill it represents are inseparable property rights. When a company acquires a trademark and the goodwill associated therewith, "[t]he value of what it obtains is tied to the underlying business that generates the goodwill associated with the trademarks." Use of the trademarks and trade names benefits all involved, including the owner. One benefit to the owner is the goodwill provided by those who market trademarked goods and services, because customers may not know that they are buying trademarked goods and services from someone other than the owner of the trademark. Another benefit to the licensor is penetration of the economic markets where the goods and service are provided. Separation of trademarks and trade names from the owner renders ownership of the trademarks and trade names useless without the concomitant access to the markets provided by the user. *Id.* at 187, 131 P.3d 37.

The New Mexico Court of Appeals' discussion respecting licensing of trademarks and trade names accurately describes the true nature of trademark licensing contracts, and is clearly applicable to this matter. The Petitioner retained a property right in the licensed trademarks and trade names it licenses. It made certain contractual demands of its licensees respecting the

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[3] The Court of Appeals of New Mexico held that the New Mexico statute taxed the gross receipts in question, and that taxation of those receipts did not violate the Commerce Clause. The Supreme Court of New Mexico ultimately determined that the New Mexico statute did not tax the gross receipts in question. However, the discussion of the Court of Appeals respecting the nature of trademark licensing and the constitutional principles articulated by it appear to be sound and should be followed.

trademarks and trade names, including maintenance of quality and the payment of royalties. The licensees were required to maintain the goodwill of the trademarked and trade-named products.[4]

The licensing contracts provide that the licensee shall have a non-exclusive right to use the trademarks in developing, manufacturing, promoting, distributing, marketing and selling licensed goods "throughout the United States, its territories and possessions." Thus, the Petitioner permits its licensees to sell the trademarked products into the fifty states, including West Virginia. The Petitioner financially benefits from its licensees' penetration of the various economic markets throughout the United States, including West Virginia. Ownership of the trade names and trademarks would be virtually worthless without this penetration of economic markets by its licensees. The Petitioner not only knows that its licensees will penetrate the economic markets of various states, it expects it and readily accepts the benefit therefrom. As described herein, the rights and benefits owned by the Petitioner in its trademarks and trade names are inseparable from the rights and duties of its licensees. By licensing its trademarks and trade names to be sold in the State of West Virginia, the Petitioner has purposefully availed itself of the economic market that is the State of West Virginia. As held by the New Mexico Court of Appeals, this constitutes a substantial nexus with the State. *See also Geoffrey (La.)*, 984 So.2d at 128; *Geoffrey (Mass.)*, 453 Mass. at 14-5, 899 N.E.2d at 93*; KMart Properties, Inc.*, 139 N.M. at 189, 131 P.3d at 39; *A&F Trademark*, 167 N.C.App. at 162, 605 S.E.2d at 195; *Geoffrey (Okla.)*, 132 P.3d at 638-39; *Geoffrey (S.C.)*, 313 S.C. at 23-24, 437 S.E.2d at 18; and Arizona Dept. of Revenue, Case No. 200700083-C (March 27, 2008).

This is consistent with the decision of the Supreme Court of Appeals of West Virginia in *MBNA*, *supra*. Although *MBNA* did not involve the taxpayer licensing trademarks or other

[4] The customers don't necessarily know that it is the licensee that is maintaining the quality of the product. The customers just know they are buying a product of a known quality.

intangible personal property to West Virginia residents, the Commerce Clause considerations articulated by the Court are relevant to this matter. In *MBNA*, the Supreme Court held that a "substantial economic presence standard" was an appropriate indicator of whether substantial nexus exists for purpose of the Commerce Clause. The Court determined that a substantial economic presence standard incorporated due process purposeful direction towards a state while examining the degree to which a taxpayer has exploited the local market. This involves an examination respecting both the quality and the quantity of its economic presence. This test requires a determination that the taxpayer satisfies the Due Process minimum contacts standard and the additional examination of the frequency, quantity and systematic nature of its contacts with a state. *Id*. at 171, 640 S.E.2d at 234.

The Petitioner attempts to compartmentalize the transactions, arguing that it licenses its trademarks and trade names to independent companies and that it has no further participation in the sale of products bearing its trademarks and trade names. Its position seems to be that it has no interest in or responsibility for what its licensees do beyond that point. However, as described by the New Mexico Court of Appeals, this disregards the economic realities of trademark licensing transactions. In those instances where the Petitioner and its licensees are affiliated companies, this content is even less meritorious. The Petitioner can hardly be heard to argue that affiliated companies are not working in concert to achieve a unitary goal. For example, the Petitioner develops national marketing strategies for its products. Another example is the fact that the Vice-President, Tax, for all Corporation entities was present at the hearing. These examples tend to demonstrate intercompany cooperation towards a single goal.

There is no question that the Petitioner had a substantial economic presence in West Virginia. Products bearing its trademarks and trade names can be found in many, perhaps most, retail stores in West Virginia that sell food products. Its licensees' products include foods that can be found in most departments in retail grocery stores. They include prepared poultry, such as turkey and chicken, processed and smoked meats, breads, pastas, canned food, boxed processed dishes, frozen food, jarred food, sandwich spreads, pre-packaged meals, entrees and side dishes, dairy products, desserts, condiments and canned, bottled and frozen drinks.[5] One can view advertisements of the Petitioner's trademarked and trade-named products on national, regional and local television broadcasts. One can receive printed advertisements of the Petitioner's trademarked and trade-named products in local newspapers, in mailed circulars, which sometimes include manufacturers' coupons, and in grocery stores. A shopper in a grocery store may see in-store advertisements directing his or her attention to the Petitioner's trademarked and trade-named products. All of these advertisements are designed to exploit the local market. The Petitioner oversees the national marketing strategy. The Petitioner may not be responsible for all of these advertisements, but they are undertaken on behalf of the Petitioner with its consent, which is implied if not express. The Petitioner wants its products sold in this State, benefits from the sale of said products in this State, does nothing to prevent the marketing and sale of its trademarked and trade-named products in this State, and, in fact, encourages marketing and sale in this State. The fact that others benefit from the sale of the Petitioner's products does not mean that it does not benefit. The benefit inures to all involved.

The benefit that flows to the Petitioner as a result of the sale of its trademarked and trade-named products in this State is substantial. The calculated amounts of the sales attributable to West Virginia are set out below. The starting point for these figures was the royalties paid to the Petitioner by four licensees identified in the Multistate Tax Commission audit. The higher of the

[5] The trademarks and trade name in lists attached to the contracts is a veritable laundry list of familiar brand names.

two figures was based on a royalty of 2.5%, while the lower figure was based on a royalty of 6%.[6] The figures are determined as follows:

Corporation B

	Computed W. Va. Sales	Royalties	Computed W. Va. Sales	Royalties
05/31/01	$____ x 2.5% =	$____	$____ x 6.0% =	$____
05/31/02	____ x 2.5% =	____	____ x 6.0% =	____
05/31/03	____ x 2.5% =	____	____ x 6.0% =	____

Company C

	Computed W. Va. Sales	Royalties	Computed W. Va. Sales	Royalties
05/31/01	$____ x 2.5% =	$____	$____ x 6.0% =	$____
05/31/02	____ x 2.5% =	____	____ x 6.0% =	____
05/31/03	____ x 2.5% =	____	____ x 6.0% =	____

Company D

	Computed W. Va. Sales	Royalties	Computed W. Va. Sales	Royalties
05/31/01	$ ____ x 2.5% =	$ ____	$ ____ x 6.0% =	$ ____
05/31/02	____ x 2.5% =	____	____ x 6.0% =	____
05/31/03	____ x 2.5% =	____	____ x 6.0% =	____

Company E

	Computed W. Va. Sales	Royalties	Computed W. Va. Sales	Royalties
05/31/01	$1,856,092 x 2.5% =	$ 46,402	$ 773,372 x 6.0% =	$ 46,402

According to the audit conducted by the Multistate Tax Commission, these four licensees[7] made sales of Petitioner's trademarked or trade-named products of somewhere between $____ and $_____ for the three years that were the subject of the audit, or between $____ and $____ per year. As noted, the actual figure almost certainly is between these two figures. Even if one takes the lower of the two figures, there is substantial penetration of West Virginia's economic forum. The Petitioner has earned substantial royalties which are attributed to West Virginia sales.

[6] In most of the licensing agreements, the highest royalty was 6.0% and the lowest was 2.5%. Given that there were royalty rates between 2.5% and 6.0% and that it is a virtual impossibility that all sales were of products with either the highest rate or the lowest rate, the actual figure is probably somewhere in between.

[7] Two of the licensees have the same name. One appears to have ceased business and filed a final tax return during the year ending May 31, 2001. It appears that the other may have commenced business in the same year. The total sales of the two licensees for that year are in the range of sales for the "second" company for the last two years of the audit period.

The substantial economic presence test requires consideration of the frequency, quantity and systematic nature of its contacts with a state. These figures demonstrate the frequency, quantity and systematic nature of its contacts with West Virginia. The continuous presence of its trademarked and trade-named products demonstrates the frequency and systematic nature of its contacts. Advertising in all of its forms demonstrate all of these factors. The presence of its licensees demonstrates the systematic nature of its contacts with the State. That the Petitioner has a "substantial economic presence" in the State of West Virginia is beyond question. The Petitioner has substantially and purposefully availed itself of West Virginia's economic forum.

The Petitioner has challenged the taxes on the grounds that it is not fairly related to the service provided by the State of West Virginia. This argument is without merit. The State provides an orderly society with police and fire protection, and roads and other infrastructure that allows the Petitioner and its licensees to market its trademarked and trade-named products to customers located in West Virginia. It also allows customers access to the trademarked and trade-named products. The taxes collected are fairly related to the benefits provided by the State.

With respect to the fair apportionment and discrimination prongs of the *Complete Auto* test, the Petitioner has presented no evidence which would tend to support these contentions. The Multistate Tax Commission appears to have properly apportioned the taxes based on the sales apportioned to the West Virginia. There is nothing in the record to show that the taxes discriminate against the Petitioner because it is engaged in interstate commerce. To the contrary, it appears that the taxes treat the Petitioner in the same manner as it would treat taxpayers located in West Virginia.

The Respondent contends that the creation of the Petitioner and the sale of the trademarks and trade names to the Petitioner are a "sham" transaction. He maintains that the sole purpose of these transactions is to evade tax. While there is little evidence in the record regarding the tax planning involved in the creation of the Petitioner, if the Petitioner were to prevail there would be tax advantages to the Corporation's family of companies. The Petitioner would not be taxable in West Virginia (or, presumably, if it had its way, in most other states). The licensee-companies would be able to deduct the royalties they pay to the Petitioner, thereby substantially reducing their incomes. Present at the hearing was the Vice-President, Tax, for all the Corporation's entities. The existence of such a position would tend to indicate that the Corporation's companies engage in intercompany tax planning, which was a consideration, if not a primary reason, for creating the Petitioner.

It is irrelevant whether or not tax planning was a primary consideration in the structuring of these transactions or not, or whether the Respondent is correct in his contention that the transaction is a sham. The issue is whether the Petitioner may be constitutionally subjected to taxation by the State of West Virginia. As decided above, it is subject to the taxes assessed.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code § 11-10A-10(e) [2002]; W. Va. Code. St. R. §§ 121-1-63.1 and 69.2 (Apr. 20, 2003).

2. As applied to the Petitioner, who licenses trademarks and trade names to others, including affiliated companies, who then sell trademarked and trade-named products to customers in West Virginia, the West Virginia business franchise tax, W. Va. Code § 11-23-1, *et seq.*, does not violate the Due Process Clause of the United States Constitution, *U. S. Const.*

amend XIV, § 1, because the Petitioner has minimum contacts with the State of West Virginia and the tax is rationally related to values connected with the taxing State.

3. As applied to the Petitioner, the West Virginia corporation net income tax, W. Va. Code § 11-24-1, *et seq*., does not violate the Due Process Clause of the United States Constitution, *U. S. Const. amend XIV, § 1*, because the Petitioner has minimum contacts with the State of West Virginia and the tax is rationally related to values connected with the taxing State.

4. As applied to the Petitioner, the West Virginia business franchise tax, W. Va. Code § 11-23-1, *et seq*., does not violate the Commerce Clause of the United States Constitution, *U. S. Const. art 1, § 8, cl. 3*., because: 1) The Petitioner has a substantial nexus with the State of West Virginia, 2) The tax is fairly apportioned to the State of West Virginia, 3) The tax does not discriminate against interstate commerce, and 4) the tax is fairly related to the benefits provided by the State.

5. As applied to the Petitioner, the West Virginia corporation net income tax, W. Va. Code § 11-24-1, *et seq*., does not violate the Commerce Clause of the United States Constitution, *U. S. Const. art 1, § 8, cl. 3*., because: 1) The Petitioner has a substantial nexus with the State of West Virginia, 2) The tax is fairly apportioned to the State of West Virginia, 3) The tax does not discriminate against interstate commerce, and 4) the tax is fairly related to the benefits provided by the State.

6. The Petitioner in this matter has failed to carry its burden of proving that the assessments of taxes against it are erroneous, unlawful, void or otherwise invalid.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the corporation net income tax assessment issued against the Petitioner for the period of June 1, 2000, through May 31, 2003, for tax in the amount of $____ and interest in the amount of $____, computed through August 31, 2006, totaling $60,801, should be and is hereby **AFFIRMED**.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that business franchise tax assessment issued against the Petitioner for the period of June 1, 2000, through May 31, 2003, for tax in the amount of $____, and interest in the amount of $____, computed through August 31, 2006, totaling $____, should be and is hereby **AFFIRMED**.

Interest continues to accrue on the unpaid tax until the liability is fully paid.