STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ALPHARMA, INC.	:	DECISION DTA NO. 817895
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1993, 1994 and 1995.	:	

Petitioner Alpharma, Inc., One Executive Drive, Fort Lee, New Jersey 07024-1399 and the Division of Taxation, filed exceptions to the determination of the Administrative Law Judge issued on September 12, 2002. Petitioner appeared by McDermott, Will and Emery (Arthur R. Rosen, Esq. and Alysse Grossman, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Clifford M. Peterson, Esq., of counsel).

Each party filed a brief in support of its exception, briefs in opposition and briefs in reply. Oral argument, at the request of the parties, was heard on February 11, 2004 in Troy, New York.

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

ISSUES

I. Whether the Division of Taxation has properly imposed corporation franchise tax on the Alpharma Group nontaxpayer corporations[1] by including the New York destination sales of

[1] The corporations which comprised the Alpharma Group nontaxpayers, around which this matter is centered, are Able and Barre-National in 1993; Able, Barre-National and Wade Jones in 1994; and Alpharma and Barre-National in 1995.

such corporations in the numerator of the receipts factor of the business allocation percentage of the combined group, or whether such sales of nontaxpayer corporations are immune from New York corporation franchise tax due to the protections afforded by the Commerce Clause of the United States Constitution or by Public Law 86-272.

II. Whether New York State improperly exercised jurisdiction over the nontaxpayer corporations of the unitary group.

III. If, in fact, New York State has jurisdiction, whether the subject receipts must be included in the numerator of the receipts factor used in the apportionment formula in order to avoid distortion.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

1. The Division of Taxation ("Division") issued Notice of Deficiency #L-017607509-9 ("Notice"), dated April 17, 2000, to Alpharma, Inc. ("Alpharma"), asserting additional corporation franchise taxes for tax years 1993, 1994 and 1995. The total additional tax asserted in the Notice was $173,858.00, plus interest and penalty in the amount of $78,662.05 and $28,828.50, respectively, for a total of $281,348.55. The adjustments that resulted in the additional tax liability asserted on the Notice for the years 1993 and 1994 did not result from sales of shipments of tangible personal property to points within New York State and are not being contested in this proceeding. The subject Notice does include, however, an adjustment to the numerator of the receipts factor based on the Division's position that petitioner incorrectly

excluded from the numerator, the receipts from the sales that resulted from shipments to points within New York State.

2. On or about January 30, 1992, Alpharma (formerly known, at different times, as A.L. Laboratories, Inc. and A. L. Pharma Inc.) corresponded with the Division requesting permission to file a combined report with some of its subsidiaries pursuant to the franchise tax regulations for the year ending December 31, 1991 and subsequent years ("initial request"). The letter, prepared by Robert A. Pudlak, then Vice President, Finance and Chief Financial Officer (who was transferred to Able Laboratories after October 1992), established that A.L. Laboratories, Inc. (petitioner herein) owned directly 100% of the stock of G. F. Reilly Company (incorporated in Delaware), A.L. Specialty Chemicals, Inc. (incorporated in Illinois), ParMed Pharmaceuticals, Inc. (incorporated in Delaware), Barre Parent Corporation (incorporated in Delaware), Biomed (incorporated in Washington), and NMC Laboratories, Inc. (incorporated in New York). Further, Barre Parent owned directly 100% of the stock of Barre-National, Inc. (incorporated in Maryland). The correspondence concluded that the capital stock requirement for combined filing was met.

Concerning the unitary business requirement of 20 NYCRR 6-2.2(b), the initial request set forth the following information concerning the relationship between the corporations:

<u>A.L. Laboratories, Inc.</u>

> A.L. Laboratories, Inc. consists of two divisions, one which manufactures and sells animal health products ("Animal Health") and the corporate division which is directly involved with the management of all subsidiaries and the Animal Health division. These management activities performed on behalf of subsidiaries and Animal Health include among others, the selection of key executive personnel, certain research and development, budgeting, treasury, legal, financing, compensation and major decision making (such as approval of large expenditures and approval of subsidiaries marketing plans). In certain

cases, individuals performing full-time management services for subsidiaries are employees of A.L. Laboratories, Inc. and are directly compensated, supervised and controlled by the parent.

G. F. Reilly Company

G. F. Reilly Company ("Reilly") has unitary ties with the parent and a subsidiary of the parent. G. F. Reilly owns a building in Maryland. Reilly is contractually obligated to lease that building (its principal asset) to Barre-National, Inc. who is a second tier subsidiary of the parent. In fact, in 1991 100% of Reilly's taxable income was derived from rental receipts obtained from Barre-National Inc. Unitary ties with the parent are evidenced by the fact that Reilly has no employees; all decisions with respect to Reilly are made by executives of A. L Laboratories, Inc. many of whom are also non-compensated officers of Reilly.

A. L. Specialty Chemicals, Inc.

A. L. Specialty Chemicals, Inc. ("Specialty") is unitary with the parent due to its usage of A. L. Laboratories, Inc.'s manufacturing facilities and employees in Illinois. In addition, most officers of Specialty are also executives of the parent. Since Specialty has no employees of its own, all decisions including those affecting Specialty's day-to-day operations are made by A. L. Laboratories, Inc.

ParMed Pharmaceuticals, Inc.

ParMed Pharmaceuticals, Inc. ("ParMed") has unitary ties since it provides backup computer storage capacity for the parent and certain subsidiaries. An employee of the parent (Director of MIS) oversees ParMed's computer operations. Furthermore, NMC Laboratories, Inc. ("NMC") a subsidiary of the parent, utilizes ParMed facilities for virtually all their computer needs. An attempt is made to recover ParMed's costs for computer services in the form of intercompany charges, however, there is no profit element; this represents a distortion.

Other unitary ties between ParMed and certain affiliates include intercompany purchases of pharmaceutical products and related product lines. For instance, substantially all of ParMed's liquid and dermatological products are supplied by Barre and NMC, respectively. The parent, as with other subsidiaries, also exerts an overwhelming amount of control over ParMed in areas such as financing, budgeting, choice of key executives and major decision making.

Barre Parent Corporation

Barre Parent Corporation ("Barre-Parent") has no income or expenses. Barre-Parent's purpose is to hold the stock of Barre-National, Inc. ("Barre"). As discussed below, Barre clearly has a unitary relationship with A. L. Laboratories, Inc. and certain affiliates. In our opinion, the unitary ties of Barre and the relationship between Barre-Parent and its subsidiary would satisfy the unitary requirement for both companies.

Barre-National, Inc.

Barre-National, Inc.'s unitary relationship with A.L. Laboratories, Inc. and certain affiliates is evidenced by intercompany sales, an intercompany lease, common officers, common customers and an evolving common sales force. Intercompany sales are made between Barre and ParMed and between NMC and ParMed. As mentioned previously, there is an intercompany lease between Reilly and Barre (Barre leases its manufacturing facility in Maryland from Reilly). Some of the officers of Barre are also officers of A. L. Laboratories, Inc. and NMC. In fact, George Barrett, who is the president of NMC and Barre, divided his time almost equally in 1991 among both companies. NMC and Barre manufacture and sell human pharmaceuticals. ParMed sells human pharmaceuticals. The operations of Barre and NMC are closely integrated as evidenced by certain common customers (including ParMed) and common management.

Biomed, Inc.

Biomed, Inc. ("Biomed"), has a unitary relationship with the parent. Biomed develops, manufactures and markets bacterins used to immunize fish against disease while A.L. Laboratories, Inc.'s Animal Health Division manufactures and markets feed additives and antibiotics for poultry and swine. Thus, both companies are in a related line of business. In fact, Mr. Robert Busch who is the vice president and general manager of Biomed, reports directly to Mr. David Cohen who is the president of the parent's Animal Health Division. Mr. Busch also participates in the parent's compensation package. As with other subsidiaries, the parent exerts control over Biomed in areas such as legal, treasury, financing, budgeting, hiring of key executives and major decision making. Biomed also relies heavily upon Animal Health for financial reporting assistance and utilization of computer facilities. In fact, Animal Health Division and Biomed are combined for financial segment reporting purposes.

NMC Laboratories, Inc.

NMC has unitary relationships with the parent, with Barre and ParMed. Some of the unitary ties, as mentioned previously, include a common president (Barre and NMC), intercompany sales and purchases and utilization of ParMed's computer

> services. NMC uses ParMed's facilities for a significant amount of their computer needs. In addition, the parent exercises unitary control over NMC as with all of its subsidiaries by making major decisions, overseeing operations, hiring certain executives and approving budgets and major expenditures. A. L. Laboratories, Inc. also guarantees NMC's line of credit.

After concluding that the unitary business requirement was met, petitioner asserted that filing on a separate basis would distort the activities, business income and capital in New York State. The correspondence stated that:

> Distortion would be attributed not only to intercorporate transactions but also to the value which flows between members of the affiliated group, as evidenced by the following:
>
> - Management, control and direction of the affiliated group are critical activities performed by the Board of Directors and Officers of A. L. Laboratories, Inc.
>
> - Expenses of the parent including legal, treasury, financing, stewardship, accounting, certain payroll expenses, tax preparation, risk management, business development, certain research and development and other expenses incurred at the headquarters are not allocated to subsidiaries which causes an overstatement of income for subsidiaries and an understatement of the parent's income.
>
> - An attempt is made to reimburse ParMed for computer storage services (discussed above) provided to other members of the Group. However, the intercompany charges made by ParMed to other members of the Group are not designed to yield an arm's-length profit but rather are designed to cover ParMed's cost.
>
> - Amongst all of A. L. Laboratories, Inc.'s companies, there is a sharing of development capabilities and operating technologies. For example, NMC is in the process of obtaining FDA approvals on three new dermatological formulas that are expected to be made available to ParMed which will cause a distortion of income and expenses between those companies.
>
> In summary, the distortion requirement is satisfied due to the overwhelming synergy between the companies. The close interrelationships of the companies and integration of their businesses have given rise to a variety of

> intercompany transactions which makes it extremely difficult to determine the accurate computation of income on a separate company basis. Only a combined return can correct such distortions.

3. By correspondence dated March 13, 1992, the Division granted tentative permission to Alpharma (then known as A.L. Laboratories, Inc., EIN 22-2095212) and the subsidiaries listed below, to file a combined report commencing with the period ending December 31, 1991:

A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Barre-National, Inc.	EIN 52-0577546
Biomed, Inc.	EIN 91-1089227
G. F. Reilly Company	EIN 22-2509324
NMC Laboratories, Inc.	EIN 11-2566658
ParMed Pharmaceuticals, Inc.	EIN 16-1276038
Barre Parent Corporation	EIN 34-1536575

4. Alpharma filed a combined report including the subsidiaries listed in its initial request (“1991 Alpharma Group”), for purposes of the tax imposed by Article 9-A of the New York State Tax Law (the “Article 9-A tax”), for the year ending December 31, 1991. The 1991 Alpharma Group consisted of the following companies:

A.L. Laboratories, Inc. (petitioner herein)	EIN 22-2095212
A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Barre-National, Inc.	EIN 52-0577546
Biomed, Inc.	EIN 91-1089227
G. F. Reilly Company	EIN 22-2509324
NMC Laboratories, Inc.	EIN 11-2566658

ParMed Pharmaceuticals, Inc.	EIN 16-1276038
Barre Parent Corporation	EIN 34-1536575

5. Alpharma filed a combined report including certain of the subsidiaries (detailed *infra*), for purposes of the tax imposed by the Article 9-A tax, for each of its tax years, 1993, 1994 and 1995.

The 1993 Alpharma Group

6. Alpharma, together with the subsidiaries included in the combined report it filed for 1993, will be referred to as the "1993 Alpharma Group." The 1993 Alpharma Group consisted of :

Alpharma	EIN 22-2095212
A.L. Specialty Chemicals, Inc.	EIN 36-3374030
Able Pharmaceutical, Inc.(also known as Able Laboratories, Inc.) ("Able"[2])	EIN 22-3192695
Alpharma USPD, Inc.(also known as Barre-National, Inc.) ("Barre-National"[3])	EIN 52-0577546
Alpharma NW Inc. ("NW")(formerly known as Biomed, Inc.)	EIN 91-1089227
G. F. Reilly Company ("Reilly")	EIN 22-2509324
NMC Laboratories, Inc. ("NMC")	EIN 11-2566658
ParMed Pharmaceuticals, Inc. ("ParMed")	EIN 16-1276038

[2] For consistency throughout the determination, and to eliminate any confusion, Odin Pharmaceutical, Inc., which was also known as Able Laboratories, Inc. will be referred to as "Able."

[3] For consistency throughout the determination, and to eliminate any confusion with the United States Pharmaceutical Division, references to "USPD," where intended to refer to Barre-National, will be replaced by the corporate name Barre-National.

For the members of the 1993 Alpharma Group that were included in the initial request and the 1991 Alpharma Group, their inclusion in the 1993 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State, such that it would be "extremely difficult to determine the accurate computation of income on a separate company basis").

Able was not a subsidiary included in the 1991 Alpharma Group. The inclusion of Able in the 1993 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2 (b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State).

7. Specialty Chemicals, Able, Barre-National, NW and Reilly were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1993. These subsidiaries did not pay the fixed minimum tax on the combined return nor has the Division asserted that they should pay the fixed minimum tax.

The 1994 Alpharma Group

8. Alpharma, together with the subsidiaries included in the combined report filed for 1994, will be referred to as the "1994 Alpharma Group." The 1994 Alpharma Group consisted of:

Alpharma	EIN 22-2095212
Specialty Chemicals	EIN 36-3374030

Able	EIN 22-3192695
Barre-National	EIN 52-0577546
NW	EIN 91-1089227
Reilly	EIN 22-2509324
NMC	EIN 11-2566658
ParMed	EIN 16-1276038
Alpharma Animal Health Company ("Wade Jones") (also known as "Animal Health")[4]	EIN 75-1763319

For the members of the 1994 Alpharma Group that were included in the initial request and the 1991 Alpharma Group, their inclusion in the 1994 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

9. Wade Jones was not a subsidiary included in the initial request and the 1991 Alpharma Group. The inclusion of Able and Wade Jones in the 1994 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

10. Specialty Chemicals, Able, Barre-National, NW, Reilly and Wade Jones were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1994. These subsidiaries did not pay the fixed minimum tax on the combined report, nor has the Division asserted that they should pay the fixed minimum tax.

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[4] This company will be consistently referred to as "Wade Jones."

The 1995 Alpharma Group

11. Alpharma, together with the subsidiaries included in the combined report it filed for 1995, will be referred to as the "1995 Alpharma Group." The 1995 Alpharma Group consisted of:

Alpharma	EIN 22-2095212
Specialty Chemicals	EIN 36-3374030
Able	EIN 22-3192695
Barre-National	EIN 52-0577546
NW	EIN 91-1089227
Reilly	EIN 22-2509324
NMC	EIN 11-2566658
ParMed	EIN 16-1276038
Wade Jones	EIN 75-1763319
Alpharma U.S. Inc. ("US")	EIN 22-3322528

For the members of the 1995 Alpharma Group that were included in the initial request and the 1991 Alpharma Group, their inclusion in the 1995 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e., that filing on a separate basis would distort the activities, business income and capital in New York State).

12. US was not a subsidiary included in the initial request and the 1991 Alpharma Group. The inclusion of Able, Wade Jones and US in the 1995 Alpharma Group meets the requirements of 20 NYCRR 6-2.2(a) (the capital stock requirement), 20 NYCRR 6-2.2(b) (the

unitary business requirement), and 20 NYCRR 6-2.3 (the other requirement, i.e. that filing on a separate basis would distort the activities, business income and capital in New York State).

13. After October 3, 1994, all of the members of the 1995 Alpharma Group, other than Alpharma or US, were second or third tier subsidiaries of Alpharma. After October 3, 1994, a holding company known as A.L. Laboratories, Inc., which is a first tier subsidiary of Alpharma, was formed to hold the stock of the 1995 Alpharma Group, other than Alpharma and US. This structure is reflected on an organizational chart labeled "A.L. Pharma Inc. & Subsidiaries" with a handwritten note "After 10/3/94 Before 9/15/95." In 1995, A.L. Laboratories changed its name to Alpharma U.S. Inc. (US). While US and Alpharma have, at different times, shared the same name, i.e., A.L. Laboratories, Inc., they have always been separate entities.

14. Alpharma, Specialty Chemicals, Able, Barre-National, NW, Reilly, Wade Jones and US were not subject to the imposition of the Article 9-A Tax for the year ending December 31, 1995. These companies did not pay the fixed minimum tax on the combined report nor has the Division asserted that they should pay the fixed minimum tax.

15. During the audit, petitioner did not assert that the reasons for its filing a combined report as stated in the January 1992 correspondence had changed.

Alpharma and the Animal Health Division

16. During the years in issue, 1993 through 1995, Alpharma, Inc. ("petitioner" or "Alpharma"), the parent company, was primarily involved in the manufacture of pharmaceuticals for the animal health industry as well as the sale of fine chemicals in the United States. Fine chemicals are the active ingredients used in finished (human) pharmaceuticals.

17. From 1993 through 1995, petitioner did not lease or own any facilities in New York, or have any business equipment in New York. Alpharma's primary facilities were located in Fort Lee, New Jersey and Chicago Heights, Illinois. During the audit period, petitioner had one sales representative, whose office was located in Fort Lee, New Jersey, soliciting sales in New York State who represented petitioner's Fine Chemical Division. His job was to call on customers in New York and present the products (about 10 of them) sold by petitioner. The targeted customers would be Pfizer, Burroughs-Wellcome, and other small generic manufacturers, all of whom manufacture finished dose human pharmaceuticals. The salesperson did not have the authority to accept orders and did not employ the use of any type of display racks for the products. The sales orders were accepted in Fort Lee, New Jersey or in Europe where the manufacturing of such products took place.

In addition to the representative from the Fine Chemical Division, petitioner had another sales representative, Tom Wagner, the head of corporate information technology, who would visit New York a few times a year conducting business activities in the state. His office was located in Fort Lee, New Jersey and he spent about 20% of his time in New York and 20% of his time in New Jersey. While in New York, he would work out of the offices of ParMed, a subsidiary of petitioner, in Niagara Falls, New York. The balance of Mr. Wagner's time was spent overseas or in another of petitioner's subsidiaries in Baltimore, Maryland. Mr. Wagner's position was eliminated in 1994. It was on the basis of Mr. Wagner's part-time work in New York prior to 1994 that petitioner considered itself a New York taxpayer for franchise tax purposes. The Division and petitioner agree that Alpharma was not a taxpayer in New York in 1995, but do not agree on the basis for petitioner's nontaxpayer status.

18. In 1992, when petitioner filed its request for permission to file on a combined basis for New York corporation franchise tax purposes, petitioner described itself as a parent company that consisted of two divisions, "one which manufacturers and sells animal health products ("Animal Health") and the corporate division which is directly involved with the management of all subsidiaries and the Animal Health division." Future annual reports and 10-K filings with the Securities and Exchange Commission ("SEC") thereafter describe petitioner as a parent company "with two business segments, the Pharmaceutical segment and the Animal Health and Bulk Antibiotic segment" (***see***, SEC Form 10-K, 12/31/93), a parent company "with five operating divisions, three in Human Pharmaceuticals and two in Animal Health" (***see***, 1994 Annual Report) and a parent company "with five operating divisions included in two business segments, Human Pharmaceuticals and Animal Health" (***see,*** SEC Form 10-K, 12/31/95).

19. In July 1991, petitioner's board of directors established the office of the chief executive to assume the top management role of petitioner, and "to assure the continuity of the long-established direction and strategy of [petitioner]." The three-member office included Einar Sissener, chairman of the board and founder of A. L. Laboratories, I. Roy Cohen, vice chairman and former president and chief executive officer of the company from its inception until January 1991, and Jeffrey Smith, the executive vice president, described as having full operating responsibility for the company, and having played a key role in refining and executing petitioner's strategy since 1984 as vice president of finance and chief financial officer. In 1993, petitioner's management was strengthened by Sissener's acceptance of greater responsibility for petitioner's operations within the office of the chief executive. Both Sissener and Smith held their named positions in the office of the chief executive from July 1991 through May 1994.

20. In the 1992 Annual Report, Sissener, Smith and Cohen are depicted as working closely with the senior management of each of the specialty businesses, particularly, David Cohen, president of Animal Health, and George Barrett, president of Barre-National and NMC. The report stated that:

> This *ongoing interchange* assures continued reassessment of strategies in the context of our long-standing philosophy, evaluation of new opportunities, and a *critical analysis of business activities*, which facilitates the most efficient use of our global capabilities (emphasis supplied).

21. In 1992, a special committee of petitioner's board of directors was appointed to evaluate the feasibility of combining petitioner with the related pharmaceutical, animal and aquatic health and bulk antibiotic businesses of a Norwegian corporate group. During 1993, the special committee together with petitioner's management and the board of directors, discussed various proposed structures and terms of a transaction in which the related businesses would become part of petitioner. As set forth in petitioner's SEC Form 10-K filing for the period ended December 31, 1994, on October 3, 1994, petitioner completed the transaction in which it acquired the pharmaceutical, bulk antibiotic, animal health and aquatic animal health businesses of a Norwegian company, hereinafter referred to as the "combination transaction." Subsequent to the combination transaction, petitioner was reorganized into five operating divisions which included two business segments, Human Pharmaceuticals and Animal Health. The Human Pharmaceuticals segment consists of three operating divisions, U.S. Pharmaceuticals, International Pharmaceuticals and Fine Chemicals. The Animal Health segment consists of two operating divisions, Animal Health and Aquatic Animal Health.

As reported in petitioner's SEC Form 10-K for 1995, after the closing of the combination transaction, each division was required to evaluate its business to determine actions necessary to maximize the division's and petitioner's competitive position. As a result, in December 1994, petitioner's board of directors approved a plan and petitioner announced post-combination management actions which included exiting certain businesses and product lines which did not fit into petitioner's new strategic direction, severing certain employees employed in the businesses or product lines to be exited or whose positions had become redundant as a result of the acquisition and the sale or exiting of certain support facilities also found to be redundant.

22. Petitioner's management made a variety of other major decisions concerning acquisitions of other companies by petitioner. In 1992, petitioner acquired Able Laboratories, Inc. which became part of its Human Pharmaceuticals group. In 1994, petitioner acquired Wade Jones as part of its Animal Health segment and such acquisition was considered a noteworthy event by petitioner's 1994 Annual Report. Petitioner reported that:

> In addition to being the largest poultry animal health products distributor in the United States, Wade Jones develops, manufactures and sells its own line of animal health products. These products complement and significantly enhance the breadth of our water soluble product line. . . In total, the Wade Jones acquisition should add over $20 million in sales in 1995.

Wade Jones distributed products for Alpharma as a warehousing and trucking company, but did not solicit sales for petitioner. Petitioner did not solicit sales for Wade Jones. Approximately 90% of all products sold by the Animal Health Division in the United States in 1995 to the poultry industry were distributed by Wade Jones.

23. Petitioner's animal health care products were sold primarily to the poultry and swine industries. Within the poultry industry, the customers were typically the large integrated producers of poultry products, such as Tyson, Perdue and Conagra, located in the poultry belt from Maryland, south to Georgia and west to Arkansas. As to the swine industry, products

similar to those sold to the poultry industry were sold to pork producers through distributors in Iowa, North Carolina and parts of the mid-west.

24. Petitioner performed services for its subsidiaries with regard to finances, insurance, general management, approval of overall budgets, centralized legal services and risk management. Petitioner maintained two qualified noncontributory defined benefit pension plans covering the majority of its domestic employees. Petitioner set the pension plans' funding policies, determined the plans' investment manager and set the general investment direction. Petitioner's involvement with the subsidiaries' marketing plan was to the extent of the annual budget review. Major decisions, such as the acquisition of Able and Wade Jones, and significant capital expenditures required approval of petitioner's upper management or board of directors. Alpharma purchased insurance coverage for the members of the combined group to attain more favorable rates and coverage. There were common officers among the subsidiaries and petitioner, who were not compensated by the subsidiaries. Alpharma was not provided any reimbursement by the subsidiaries for the services of the officers.

Alpharma was responsible for the generation of its own working capital in the profitable animal health business. For the years in issue, Alpharma provided a parent company guarantee for the debts of its subsidiaries, which resulted in lower lending margins and longer term financing arrangements for the subsidiaries, particularly Barre-National, NMC, ParMed and Able. Albert Marchio, petitioner's treasurer, was directly involved with the negotiation of the credit facilities appropriate for the subsidiaries. The subsidiaries were not charged any fees for the services provided by the parent, Alpharma.

25. Petitioner's involvement with the pharmaceutical regulatory environment was described in petitioner's SEC Form 10-K for 1995 as follows:

> Since 1989 the U. S. pharmaceutical industry has been, and continues to be, subject to an intense level of scrutiny by the FDA [U.S. Food and Drug Administration] and by members of Congress. As a result of actions taken by [petitioner] to respond to the progressively more demanding regulatory environment in which it operates, the operating income of the USPD's operations has been negatively affected. *[Petitioner] has spent, and will continue to spend, significant funds and management time on FDA compliance matters.* In 1992 Barre concluded a binding agreement in the form of a consent decree with the FDA which clarified Barre's regulatory obligations (the 'Consent Decree'). The Consent Decree defines the standards Barre must achieve in meeting Current Good Manufacturing Practices ('CGMP'). In addition, USPD's Able operation is also a party to an amended consent decree with the FDA governing manufacturing operations in accordance with CGMP. In this regard, Able has engaged in extensive regulatory compliance activities which have included discontinuing certain products and making capital expenditures and increasing operating expenditures for quality assurance and control (emphasis supplied).

26. During the 1993 strengthening of petitioner's management, Beth Hecht was appointed corporate counsel and secretary. As general counsel, she spent about 20% of her time on the U.S. Pharmaceutical Group ("USPG") (Barre-National, ParMed, NMC and Able) concerns, particularly issues relating to intellectual property matters, which was her field of expertise. She spent about 15% of her time on non-US subsidiaries and the remaining 65% of her time was shared in connection with mergers and acquisitions of other companies, general corporate activities and animal health concerns. She remained corporate counsel for the entire audit period.

27. During the audit years, and prior thereto, petitioner's animal health business was very profitable, more so than the human pharmaceuticals group, and as such, funded the acquisitions of ParMed in 1985, Barre-National in 1987, NMC and Biomed in 1990, and Able in 1992. However, during the audit period, Alpharma, whose focus was the animal health business,

did not solicit sales on behalf of Able, Barre-National, or NMC, which were all human generic pharmaceutical manufacturing companies.

Human Pharmaceuticals Division

28. For the audit period, the portion of the Human Pharmaceuticals Division that is of concern involved the U.S. operations only, comprised of four wholly-owned subsidiaries of petitioner: Barre-National, NMC, Able and ParMed. In 1993, Barre-National and the USPG, occupied a 255,000 square-foot manufacturing, warehouse and office facility in Baltimore, Maryland, and an 82,000 square-foot facility in Lincolnton, North Carolina, which was acquired by Barre-National in March 1993 and used for the same purpose. Barre-National had no employees in New York and no owned or leased facilities of its own in New York. By 1995, properties of the same or larger size and in the same location were considered manufacturing and headquarters for petitioner's United States Pharmaceutical Division ("USPD")[5], and manufacturing and office space for the USPD, respectively. The Lincolnton facility space had been expanded by more than 50% during the audit period.

In 1993, NMC occupied 78,000 square feet of manufacturing, warehouse and office space leased by petitioner in Glendale, New York, which space, by 1995 was used for manufacturing and offices by the USPD. NMC was a New York taxpayer for the audit period.

In 1993, ParMed occupied a 30,000 square foot warehouse and office facility in Niagara Falls, New York, which was owned by petitioner. By 1995, a facility of the same size and space was utilized by the USPD for warehouse and office space. ParMed was a New York taxpayer for the audit period.

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[5] After the combination transaction in October 1994, the four subsidiaries which comprised petitioner's U.S. Pharmaceutical Group became the United States Pharmaceutical Division, or USPD.

In 1993, Able occupied 60,000 square feet of manufacturing, warehouse and office space leased by petitioner in South Plainfield, New Jersey, which space, by 1995, was used for manufacturing and offices by the USPD. Able had no employees in New York and no leased or owned facilities of its own in New York.

29. The SEC required 10-K filing for petitioner, then called A.L. Laboratories, Inc., for the year ended December 31, 1993 described petitioner, "the Company," as follows:

> [Petitioner] is an international pharmaceutical company engaged in developing, manufacturing and marketing specialty generic and proprietary human pharmaceuticals, animal health products and bulk antibiotics.
>
> The Company has two business segments. The Pharmaceutical segment consists of the U.S. Pharmaceutical Group and the Pharmaceutical and Oral Health Care businesses of the Company's wholly owned Danish subsidiary, Dumex Ltd. ("Dumex"). The Animal Health and Bulk Antibiotic Segment consists of the Company's Animal Health division, Biomed, Inc. ("Biomed") and Bulk Antibiotic business conducted by Dumex.
>
> Pharmaceuticals
>
> In the United States, the Company conducts a specialty generic pharmaceutical business through its U.S. Pharmaceutical Group ("USPG"). The USPG whose activities are managed by a single senior management team, is comprised of four wholly-owned subsidiaries, Barre-National, Inc. ("Barre"), NMC Laboratories, Inc. ("NMC"), Able Laboratories, Inc. ("Able") and ParMed Pharmaceuticals, Inc. Barre, acquired in October 1987, is the leading U.S. manufacturer of liquid generic pharmaceutical products. Barre manufactures approximately 200 products which are marketed nationally primarily under the "Barre" label to pharmaceutical distributors and wholesalers and retail drug chains. NMC, acquired in August 1990, is a specialized pharmaceutical manufacturer and marketer of over 45 creams and ointments for topical use, primarily prescription products. Able, acquired in October 1992, is a manufacturer and marketer of specialized prescription and over the counter pharmaceuticals with an emphasis on suppositories, as well as dermatological creams and specialty tablets. ParMed, acquired in May 1986, markets nationally primarily under the "ParMed" label a broad line of generic pharmaceuticals. ParMed has its products contract manufactured by drug manufacturers and sells primarily to independent retail pharmacists utilizing advanced telemarketing techniques.

In March, 1993, Barre, acquired a pharmaceutical manufacturing facility in Lincolnton, North Carolina ("Lincolnton"), including inventories, approved Abbreviated New Drug Applications ("ANDA") and other related assets. The facility is designed to manufacture oral liquids and topical ointments and creams.

* * *

The manufacture and sale of pharmaceuticals constitutes the Company's largest business segment.

* * *

Barre

In the United States, through Barre, the Company is the leading manufacturer of generic pharmaceutical products in liquid form. . . Barre manufactures its products in a modern 255,000 square foot facility in Baltimore, Maryland. . . Barre markets nationwide to pharmaceutical distributors, merchandising chains and wholesalers primarily under the "Barre" label through independent sales representatives and in recent years a combined U. S. Pharmaceutical sales force. . . In March 1993, Barre, acquired the Lincolnton manufacturing facility. The Lincolnton facility presently compliments both NMC and Barre in that it produces both liquids, creams and ointments. The USPG expects future productive capacity increases and/or the possible realignment of productive capacity for certain of its product line will be located at Lincolnton.

NMC

[N]MC manufacturers its products in leased facilities in Glendale, New York. . . NMC markets nationwide mainly to wholesalers and drug chains principally under the "NMC" label. NMC coordinates its sales effort as part of the USPG.

* * *

Able

[A]ble products are marketed through the combined USPG sales force and independent sales representatives nationwide to drug chains and distributors primarily by manufacturing private label products for the drug chains and distributors. Able manufactures its products in leased facilities in South Plainfield, New Jersey.

ParMed

A line of over 300 generic prescription and over-the-counter pharmaceutical products is distributed primarily under the "ParMed" label in the United States

> through ParMed, which was acquired in May 1986. The largest part of ParMed's sales are made to independent retail pharmacists in the United States. A substantial majority of ParMed's sales are made through a 40 person sales force utilizing advanced telemarketing techniques. ParMed's telemarketing program is reinforced by a direct mail program to independent retail pharmacists. ParMed's products are contract manufactured by drug manufacturers who package and label products to ParMed specifications. Most products are available from more than one source. ParMed also markets Barre, Able and NMC branded products as part of its overall strategy.

ParMed's 30,000 square foot warehouse facility and offices are located in Niagara Falls, New York.

30. Petitioner's 1993 Annual Report included the following information concerning the USPG:

> To better serve the U.S. pharmaceutical market and further strengthen the Company's competitive posture, we consolidated all of our U.S. generic pharmaceutical operations under one senior management team headed by George Barrett. The formation of the U.S. Pharmaceutical Group represents an important element of our strategy to benefit from the many leveraging opportunities in our existing business while more efficiently serving our customers.
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> * * *
>
> During the year our U.S. Pharmaceutical research and development activities were centralized in a new facility at the Bayview campus of Johns Hopkins University. This facility provides the expansion necessary to pursue continued market leadership in liquid and topical pharmaceuticals, and expand our presence in suppositories, aerosol inhalants and other targeted specialty markets.
>
> * * *
>
> U.S. Pharmaceutical Group operations posted strong revenue growth, with volume increases at our Barre-National, NMC and ParMed subsidiaries.

31. After the combination transaction in October 1994, the United States Pharmaceutical Group became known as the United States Pharmaceutical Division ("USPD"), and was comprised of the same four wholly-owned subsidiaries: Barre-National, NMC, Able and

ParMed. During the formation of the USPD, management took a number of consolidating actions. NMC, Barre-National and Able, the companies involved in the manufacture of human pharmaceuticals (ParMed was the only nonmanufacturing company in the USPD), reorganized and began to combine their marketing activities rather than continue operating as three separate companies in that regard. The result was a combined sales effort and a centralized inventory and distribution center under Barre-National. NMC and Able manufactured products for sale to Barre-National pursuant to a contract manufacturing arrangement, which then, in turn, sold to the customer. After the reorganization, neither NMC nor Able had any sales representatives. The customers they were selling to were primarily CVS and Walgreen's, located in Massachusetts and Illinois, respectively.

The sales representatives both before and after the reorganization would call on a buyer of a pharmaceutical company, present a product list, talk about pricing and service. However, the salesperson did not have the authority to accept orders. The orders were accepted in and the goods shipped from each of the manufacturing sites, and later, Columbia, Maryland. NMC, Able and Barre-National shipped goods into New York to distribution centers of the various pharmaceutical companies which were located across the country.

32. In petitioner's 1991 Annual Report, ParMed is said to have:

> [S]uccessfully applied the talents of its creative marketing staff to support Barre and NMC. Marketing strategies included implementation of an *ongoing Barre/NMC promotional program*, the targeting of special customer groups, and the support of an aggressive direct mail campaign to enhance consumer awareness and pharmacists' product knowledge. This represents a further example of the synergies between our U. S. pharmaceutical subsidiaries (emphasis supplied).

Petitioner's 1992 Annual Report demonstrates similar continuity of the synergies described above:

> In the first half of the year, a dedicated sales force was formed to more efficiently serve the overlapping customer base of our U.S. special liquids and topicals business (referring to Barre-National and NMC). As a result, NMC, our dermatologicals subsidiary, continued to increase penetration of its market segment helping to offset Barre's temporarily lowered sales. Complementing this combined Barre/NMC sales and marketing effort, ParMed Pharmaceuticals applied its sophisticated telemarketing skills and specialized programs to extend the visibility of Barre, NMC and Able products.
>
> * * *
>
> The creation of a Barre and NMC joint sales and marketing organization, launched during 1992, has been one our major strategic initiatives, and is already having a positive impact on our business. At the same time we have been able to integrate the sophisticated telemarketing capabilities of ParMed by utilizing their services to support the market efforts of our pharmaceutical operations.

Likewise, in the SEC Form 10-K for 1995, ParMed is praised:

> Through its ParMed operation, the USPD distributes a line of over 1800 generic prescription and over-the-counter pharmaceutical product presentations and offers certain custom marketing services (such as telemarketing, order processing and distribution) to the pharmaceutical industry. The largest part of ParMed's sales are made to U.S. independent retail pharmacies. A substantial majority of ParMed's sales are made through a 45 person telemarketing sales force. ParMed's products are manufactured by drug manufacturers who package and label products for ParMed. ParMed also markets products bearing the "Barre", and "NMC" labels. In addition, a special group of telemarketers is dedicated to marketing USPD products to retailers and institutional pharmacies (such as those in nursing homes).

33. During the audit period, and prior to the restructuring of the USPG to the USPD, Barre-National, NMC and Able sold their products to the related entity, ParMed, which telemarketed the products to over 6,000 independent pharmacies nationwide. According to the 1994 SEC Form 10-K, through its ParMed operation, the USPD distributed a line of over 1,800 generic prescription and over-the-counter pharmaceutical product presentations under the "ParMed" label as well as private labels in the U.S. ParMed, located in Niagara Falls, New York, had a telemarketing force that would telephone independent pharmacies and speak directly

to the pharmacist concerning its products for sale, unlike Barre-National, NMC and Able who sold to large chain companies. After the restructuring, ParMed's operations remained the same. ParMed would inform the independent pharmacies where they could obtain the products discussed. But ParMed neither took orders nor filled orders. Barre-National compensated ParMed approximately $200,000.00 for this advertising function; however, such compensation was insufficient for ParMed to actually recognize a profit element.

34. The Division provided the testimony and opinion of its expert witness, Dr. Alan Shapiro, the Ivadelle and Theodore Johnson Professor of Banking and Finance and past chairman of the Department of Finance and Business Economics, Marshall School of Business, University of Southern California. Dr. Shapiro was offered as an expert in economics, transfer pricing, corporate finance, the valuation of intangibles and the flow of values in the member corporations of an affiliated or combined group. The focus of his report, entitled *Economic Analysis of Apportionment Issues Involving Alpharma, Inc.'s Combined Tax Reports in New York State for 1993-1995*, concerns whether it is justifiable from an economic perspective to exclude from the numerator of the receipts factor component sales of tangible property shipped into New York made by operating entities of a firm, where these operating entities are not subject to tax in New York. Dr. Shapiro's report highlighted key intangibles that enabled Alpharma to develop, manufacture and profitably market its products: its regulatory skills, product and process technology expertise, marketing skills, organizational capabilities and financial resources. He noted that Alpharma also takes advantage of synergies in marketing, research and development, process technology, management, production, and logistics that cut across the entities comprising the Alpharma Group. For example, the ability to comply with

regulatory standards, is a valuable skill that takes years of experience for a company or group to develop and it was Dr. Shapiro's conclusion that petitioner has evinced such accomplishment in ample measure. Along with the experience, petitioner has acquired and dedicated significant expenditures to this critical area, and by doing so, has created a natural barrier to competition with Alpharma Group's products, thereby having a positive effect on the group's sales. Each of the intangibles and synergies referred to in his report are similarly significantly detailed. Dr. Shapiro concludes that the Alpharma Group realizes significant flows of value and synergies between its members from the intangible assets and commonalities that are shared by the members of the Group. The expert notes that petitioner has argued that the distortions associated with these synergies and flows of value can only be cured by combining the incomes of both taxpayer and nontaxpayer members of the Alpharma Group, while excluding the sales to these nontaxpayer companies from the numerator of the receipts component of the apportionment factor. Given the fact that most, if not all, of the intangible assets and synergies benefit both the income and the sales of its member entities, he concludes that such an approach would lead to distortion that would not exist if the sales of the nontaxpayer members were included in the receipts factor.

35. Petitioner introduced the testimony of Dr. Robert Cline, currently the National Director of State and Local Tax Policy Economics for Ernst & Young in Washington, D.C. He was accepted as an expert in State tax policy and in the area of corporate tax apportionment. He was requested to comment on the economic effect of the New York business allocation percentage including the sales of a company that is not a taxpayer. His testimony provided examples which he specifically prefaced with the statement that "it is not intended to be [sic]

example that's tied directly to the taxpayers in this discussion. . . ." Dr. Cline's conclusion that "from an economic perspective, New York's approach [to taxation] is contributing a much higher share of net income to New York than is realistically related to the level of economic activity," though in response to questions asked of him, was made in a very general context without any reference to the facts in issue or petitioner's unitary group. A later clarification indicated that Dr. Cline believes that "absent legal constraint that we briefly discussed [Public Law 86-272], it does make economic sense to consider payroll, property and sales as factors that get you at the location underlying economic activity and it is a reasonable approach from an economic perspective." There was no written report of this expert submitted into evidence.

36. The second expert witness presented by petitioner was Professor Richard Pomp, who is a law professor at Connecticut Law School, and adjunct professor of law at both Harvard and Columbia Law Schools, instructing in the areas of state and local taxation, Federal personal and corporate taxation, and international taxation. He was admitted to testify as an expert in tax policy and federal law. When questioned in a general sense whether, from a tax policy standpoint, New York is doing here [imposing tax] indirectly what it cannot do directly, Professor Pomp responded in a general statement without reference to the specific facts of this case, and referenced the recent U.S. Supreme Court case of ***Hunt-Wesson v. Franchise Tax Board*** (528 US 458, 145 L Ed 2d 974). Professor Pomp supports the notion of respecting the separate existence of corporations when considering whether a nontaxpayer's receipts should be included in a New York distorted combined return. He considers California a leader in the combined reporting area and related issues. There was no written report of this expert submitted into evidence.

37. In 1993, Able had $2,224,373.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1993, Barre-National had $20,753,259.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. The 1993 Alpharma Group's Article 9-A Tax return reflected these receipts as attributable to New York for purposes of computing the 1993 Alpharma Group's receipts factor.

The portion of the Article 9-A Tax that the 1993 Alpharma Group paid that is attributable to the inclusion of sales by Able and Barre-National in the numerator of its receipts factor for the year 1993 is $66,489.00. The Notice issued by the Division asserts that the 1993 Alpharma Group owes an additional $15,200.00 in Article 9-A tax for 1993 over what it has already paid with respect to 1993. After taking into account the uncontested adjustments made by the Division, if the receipts identified in the paragraph above are not included in the numerator of that year's receipts factor of the business allocation percentage, the refund that would be due the 1993 Alpharma Group is $51,289.00 (comprised of $47,398.00 of franchise tax and $3,891.00 of MTA surcharge).

38. In 1994, Able had $1,615,848.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1994, Barre-National had $12,390,642.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1994, Wade Jones had $61,104.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. The 1994 Alpharma Group's Article 9-A tax return reflected these receipts as attributable to New York for purposes of computing the 1994 Alpharma Group's receipts factor.

The portion of the Article 9-A Tax that the 1994 Alpharma Group paid that is attributable to the inclusion of sales by Able, Barre-National and Wade Jones in the numerator of its receipts factor for the 1994 tax year is $42,646.00. The Notice issued by the Division asserts that the Alpharma Group owes an additional $25,417.00 in Article 9-A Tax for 1994 over what it has already paid with respect to 1994. After taking into account the uncontested adjustments made by the Division, if the receipts identified in the paragraph above are not included in the numerator of that year's receipts factor of the business allocation percentage, the refund that would be due the 1994 Alpharma Group is $17,229.00 (comprised of $15,892.00 of franchise tax and $1,337.00 of MTA surcharge).

39. In 1995, Alpharma had $6,288,553.00 in receipts attributable to sales of tangible personal property shipped to locations in New York. In 1995, Barre-National had $20,136,974.00 in receipts attributable to sales of tangible personal property shipped to locations in New York.

The 1995 Alpharma Group's article 9-A Tax return did not reflect any of the receipts noted in the paragraph above as attributable to New York for purposes of computing the 1995 Alpharma Group's receipts factor. The portion of the tax liability assessed on the subject Notice that is attributable to the inclusion of the subject sales noted above for 1995 in the numerator of the receipts factor is $82,954.00 ($76,600.00 of franchise tax and $6,354.00 of MTA surcharge).

40. The 1995 Alpharma Group correctly excluded receipts from sales of tangible personal property made by ParMed, where shipments were made to points without New York State, in determining the numerator of its receipts factor for purposes of computing its business allocation percentage. The Division mistakenly included these receipts in determining the

numerator of the 1995 Alpharma Group receipts factor for purposes of the Notice. The amount of receipts erroneously included in the numerator of the receipts factor with respect to ParMed for 1995 is $16,853,565.00.

41. If it is determined that the receipts of Alpharma and Barre-National should be included in the numerator of the 1995 Alpharma Group's receipts factor of the business allocation percentage, the 1995 Alpharma Group will owe an additional $87,385.00 (comprised of $80,692.00 of franchise tax and $6,693.00 of MTA surcharge). If it is determined that receipts of Alpharma and Barre-National should not be included in the numerator of the 1995 Alpharma Group's receipts factor of the business allocation percentage, the 1995 Alpharma Group will owe an additional $4,430.00 (comprised of $4,091.00 of franchise tax and $339.00 of MTA surcharge).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In her determination, the Administrative Law Judge first addressed whether Public Law 86-272 applied in this case. The Administrative Law Judge discussed what she termed jurisdictional nexus. The Administrative Law Judge stated that the fact that petitioner is part of a unitary group is not alone determinative of whether sufficient nexus exists between the taxpayer and the State. The Administrative Law Judge noted that in the unitary taxation scheme, the foreign corporation's income and factors may be included in determining the tax liability of the in-state affiliate. However, the Administrative Law Judge emphasized that, without nexus, the foreign corporation does not become subject to the taxing jurisdiction.

Based upon the facts in this case, the Administrative Law Judge concluded that petitioner did not prove its entitlement to the protection set forth in Public Law 86-272. The

Administrative Law Judge pointed out that petitioner's request for permission to file on a combined basis, though made in 1992, was a significant decision in this matter. The Administrative Law Judge stated that the parties stipulated to the fact that the request for permission to file on a combined basis was properly granted. Therefore, the Administrative Law Judge reasoned that based upon the regulations, the parties agreed that the group of taxpayers must have a unitary business, satisfy the capital stock requirement, and their separate filings would result in distortion. Thus, the Administrative Law Judge concluded that the focus of the issue before her was on the relationships that the corporations had to each other and to New York, not merely what each individual corporation's relationship was to New York without reference to the unitary group.

The Administrative Law Judge determined that the unitary business is what provides a benefit to the multi jurisdictional group of corporations. Based upon that fact, the Administrative Law Judge reasoned that it necessarily follows that distortion would exist if the apportionment formula was altered such that the sales from the nontaxpayer group were allowed to be removed from the numerator. Thus, the Administrative Law Judge held that the receipts were properly included in the numerator of the receipts factor of the apportionment formula for all the tax years in question.

ARGUMENTS ON EXCEPTION

In its exception, petitioner argues that the Administrative Law Judge erred in her conclusion that Public Law 86-272 did not apply to the nontaxpayer corporations herein. Petitioner argues that the nontaxable status of the nontaxpayers must be respected even though they filed as a combined group. Moreover, petitioner alleges that the Administrative Law Judge's conclusion that the receipts of the nontaxpayer group are not entitled to Commerce Clause and Public Law 86-272 protection contradicts the facts as agreed to by the stipulation. Lastly, petitioner argues that inclusion of the sales at issue in the allocation formula is unnecessary to cure distortion.

The Division also filed an exception with respect to the Administrative Law Judge's analysis of Public Law 86-272 as it applies to the facts of this case. The Division argues that it has properly imposed tax on the combined group members by including the New York destination sales of the nontaxpayer members in the numerator of its combined receipts factor. The Division states that Public Law 86-272's limitation on a state's jurisdiction to tax the net income of a corporation does not impact a State's unitary apportionment scheme. The Division emphasizes that the inclusion of the nontaxpayers' sales in the combined receipts factor does not involve a jurisdictional question and the Administrative Law Judge erred in concluding that it was exercising jurisdiction over the nontaxpayers' New York sales by including them in the numerator of petitioner's receipts factor for the years in issue.

OPINION

We affirm the determination of the Administrative Law Judge but not for the reasons set forth in her determination.

We begin our analysis by focusing on Public Law 86-272 and whether it is wholly inapplicable to New York State's unitary apportionment scheme and, if such law is applicable, whether petitioner has demonstrated that the nontaxpayer group is entitled to the protection set forth therein.

In 1959, the United States Congress enacted Public Law 86-272 which states, in pertinent part, that:

> No State . . . shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are . . . the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State (15 USC § 381).

Petitioner's argument is that combined reporting and the unitary business principle are employed to combine the net income of the unitary group. Petitioner states that although combining the net income of the nontaxpayer corporations may be required as an initial step in fair apportionment, the inclusion of the inbound sales of the nontaxpayers in the numerator of the combined group's receipts factor is not required because there is no reason to ignore the separate status of the nontaxpayer corporations with respect to the corporation's factors.

As a unitary business, there are several characteristics demonstrating the integration, centralization of management and economies of scale which necessarily results in a flow of values between all the members of the combined group. As clarified by the Supreme Court in ***Allied-Signal***, these characteristics that demonstrate the above three factors are indicated by transactions not undertaken at arm's length, a management role by the parent which is grounded in its own operational expertise and operational strategy, and the fact that the corporations are engaged in the same line of business (***see, Allied-Signal, Inc. v. Director, Div. of Taxation***, 504 US 768, 119 L Ed 2d 533; ***see also***, ***Container Corp. of Am. v. Franchise Tax Bd.***, 463 US 159, 77 L Ed 2d 545).

To properly reflect income, an apportionment formula (i.e., the business allocation percentage) is utilized. It determines the tax liability of the combined group's taxpayer members by reference to the in-state activities of the combined group (***see***, Tax Law § 211[4]; ***Matter of U.S. Trust Corp.***, Tax Appeals Tribunal, April 11, 1996; ***see also***, ***Matter of British Land [Maryland], Inc.***, Tax Appeals Tribunal, September 3, 1992). The apportionment formula is just that: a formula. It does not give New York State jurisdiction to tax. Only the portion of the total income of petitioner's combined report that is allocated to New York is subject to New York State taxation. The inclusion of the sales in the numerator of the receipts factor is necessary to arrive at the appropriate business allocation percentage. The inclusion of the sales is not an imposition of tax upon those sales of the nontaxpayer members of the group.

As pointed out by the Division, the concept of a unitary apportionment formula has been upheld as constitutional by the Supreme Court (***see, Matter of Shell Oil Co. v. Iowa Dept. of Revenue***, 488 US 19, 102 L Ed 2d 186, ***Container Corp. of Am. v. Franchise Tax Board***, ***supra***; ***Exxon Corp. v. Wisconsin Dept. of Revenue***, 447 US 207, 65 L Ed 2d 66). As such, we find the Division's inclusion of the subject sales in the numerator of the receipts factor proper in order to determine the appropriate business allocation percentage of the combined group herein without any violation of petitioner's constitutional rights.

We have considered petitioner's other arguments made on exception and find that the Administrative Law Judge adequately dealt with them. Thus, we affirm her determination on these issues.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The exception of Alpharma, Inc. is denied;

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

4. The petition of Alpharma, Inc. is denied;

5. The refunds described above in Findings of Fact “37" and “38" are denied; and

6. The Notice of Deficiency, dated April 17, 2000, as adjusted and agreed upon as set forth in Findings of Fact “39," “40" and “41" is sustained.

DATED: Troy, New York
August 5, 2004

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner