STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

EXPRESS, INC.

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended January 30, 1988 and January 28, 1989.

In the Matter of the Petition

of

LANE BRYANT, INC.

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended February 1, 1986 through January 28, 1989.

In the Matter of the Petition

of

THE LIMITED STORES, INC.

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended February 1, 1986 through January 28, 1989.

In the Matter of the Petition

of

VICTORIA'S SECRET STORES, INC.

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended February 1, 1986 through January 28, 1989.

DETERMINATION
DTA NOS. 812330, 812331, 812332 AND 812334

Petitioner Express, Inc., P.O. Box 16000, Columbus, Ohio 43216-6000, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended January 30, 1988 and January 28, 1989.

Petitioner Lane Bryant, Inc., P.O. Box 16000 Columbus, Ohio 43216-6000, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended February 1, 1986 through January 28, 1989.

Petitioner The Limited Stores, Inc., P.O. Box 16000, Columbus, Ohio 43216-6000, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended February 1, 1986 through January 28, 1989.

Petitioner Victoria's Secret Stores, Inc., P.O. Box 16586, Tax Dept., Columbus, Ohio 43216-6000, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended February 1, 1986 through January 28, 1989.

A consolidated hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on July 20, 21 and 22, 1994.

Petitioners filed a brief and proposed findings of fact and conclusions of law on October 24, 1994. The Division of Taxation filed a brief and a reply to petitioners' proposed findings of fact and conclusions of law on January 3, 1995. Petitioners filed a reply brief and a reply to the Division's reply to petitioners' proposed findings of fact and conclusions of law on March 17, 1995. This date commenced the six-month period for the issuance of the determination in this matter. Petitioners appeared by Morrison & Foerster (Paul H. Frankel, Hollis L. Hyans and Craig B. Fields, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James P. Connolly and John O. Michaelson, Esqs., of counsel).

ISSUES

I. Whether the Division of Taxation may properly require Limited Stores, Lane Bryant, and Victoria's Secret Stores to file combined reports with, respectively, Limco Investments, Inc. ("Limco"), Lanco, Inc. ("Lanco"), and V Secret, Inc. ("V Secret") for the fiscal years ending February 1, 1986, January 31, 1987, January 30, 1988, and January 28, 1989 (the "years in issue" with respect to these companies), and whether the Division of Taxation may properly require Express to file combined reports including Expressco, Inc. ("Expressco") for the fiscal years ending January 30, 1988 and January 28, 1989 (the "years in issue" with respect to these companies).

II. If it is determined that the Division of Taxation's proposed combinations are proper, whether the Division of Taxation properly computed the interest due on the resulting deficiencies.

FINDINGS OF FACT

The Petitioners

Limited Stores, the successor entity to The Limited Stores, Inc., an Ohio corporation, was incorporated in the State of Delaware on December 16, 1981. During the years in issue, Limited Stores was engaged in the nationwide retail sale of women's clothing and accessories.

Lane Bryant was incorporated in the State of Delaware on April 26, 1982. During the years in issue, Lane Bryant was engaged in the nationwide retail sale of women's clothing and accessories.

Victoria's Secret Stores was incorporated in the State of Delaware on April 26, 1982. During the years in issue, Victoria's Secret Stores was engaged in the nationwide retail sale of women's clothing and accessories. During the period January 27, 1986 through January 1989, the corporation was also engaged in the direct marketing retail sale of women's clothing and accessories by catalogues.

Express was incorporated in the State of Delaware on January 10, 1984. During the years in issue, Express was engaged in the nationwide retail sale primarily of clothing and accessories.

Formation of the Trademark Companies

Limco

In 1963, at a time when specialty retailing was an emerging area, The Limited, Inc. opened its first store in Columbus, Ohio. As specialty retailing grew nationally, The Limited, Inc. grew with the industry.

During the early years of The Limited, Inc.'s existence, the retail clothing industry was dominated by nationally branded goods that were produced by wholesalers. In the early 1970's, The Limited, Inc. began taking a leading position in what was termed a "private label." Instead of purchasing nationally branded goods from the garment district in New York, the company had goods produced with its own label (its trademark) placed in the garment.

The company realized that the private label it was using had evolved into a brand and that it represented the emergence of a new type of intellectual property. Recognizing that this intellectual property was a very important asset to the business, and that it had a value separate and apart from the operating business, the company decided that the mark required special protection.

In 1980, the company sought advice from Stanley Schwartz, its general counsel, and Frank Colucci, its trademark counsel, on how it should protect its intellectual property, i.e., its trademark and service mark (together, the "marks"). The idea of creating a separate trademark protection company was raised and discussed at that time.

Numerous business and legal reasons were considered for the establishment of a separate company to own and protect the marks.

Using a separate trademark protection company was viewed as a way to insulate the marks in the event of some catastrophic lawsuit. Due to the merger and acquisition mania that had begun around this time, placing the mark in a separate company was viewed as a way to

protect the company in the event of a hostile takeover attempt. A separate trademark protection company also provided a centralized system to deal with the marks on a worldwide basis. Thus, if it was decided to enter into the international retailing arena, the operations of the domestic retail business would not conflict with maximizing the value of the intangible asset. Moreover, since the only way to protect the marks worldwide was to register the marks in other countries, a separate trademark protection company would permit decisions concerning the foreign registration of the marks to be made by persons with a more global view, rather than persons concerned solely with retail operations within the United States. The existence of a separate trademark protection company also allowed for the future licensing of the marks. Since the commencement and maintenance of lawsuits in foreign countries might be required to protect the marks, the existence of a separate company to own the marks also insured that the retail operations would not be dragged into such lawsuits, and would protect officers and directors of the retail operations from being harassed in litigations both domestically and outside of the United States.

For the foregoing business and legal reasons, Limco Investments, Inc. ("Limco") was incorporated in the State of Delaware on December 19, 1980, to protect the marks formerly owned by Limited Stores.

There are numerous reasons why corporations are established in Delaware. These include the flexibility of the Delaware statute, continual efforts by the Delaware Legislature to keep the statute current, the familiarity which attorneys in all states have with Delaware corporation law since it is studied in most U.S. law schools, and the favorable indemnification provisions for directors.

The minutes of the initial meeting of Limco's board of directors, held on January 29, 1981, indicate that The Limited Stores, Inc. transferred its interest in certain trademarks to Limco in exchange for 100 shares of Limco's common stock, par value $1.00. No gain was recognized by the Limited on this exchange pursuant to Internal Revenue Code § 351.

Since one of the purposes of Limco was to protect the name under which Limited Stores was operating (i.e., the name "over the door"), only that mark was transferred to Limco. Any secondary marks (i.e., other marks that were used by the operating company) remained with the operating company, Limited Stores. Two highly successful secondary marks retained by Limited Stores during the relevant period were "Outback Red" and "Forenza". Because ownership of substantially similar marks by more than one company would risk diluting the marks' protection, all of the marks that contained the word "Limited" (e.g., "The Limited" and "Limited Express") were transferred to Limco.

In selecting the Board of Directors of Limco it was decided that the Board should consist of a Delaware attorney who could give legal advice to the company; a Delaware banker, who could provide financial advice and financial services to the company; and a Delaware accountant, who could provide the company with accounting, bookkeeping, and other administrative services. The company's attorneys helped in the selection of the individuals who would fill these roles.

Lewis Black, a Delaware attorney, Roger Thompson, an executive at the Wilmington Trust Company, and Edward Jones, a partner in Gunnip & Company, a Delaware accounting firm, were all selected as Board members. Mark Davies, another executive at Wilmington Trust Company, had originally been selected as a Board member but was replaced shortly thereafter by Mr. Thompson.

Messrs. Black, Thompson, and Jones constituted three of Limco's five Board members. Prior to becoming Board members, these individuals were not employees, directors, or otherwise affiliated with either The Limited, Inc. or Limited Stores.

In addition to serving as Board members, Messrs. Black, Thompson, and Jones were each included among the group of professionals retained by Limco to provide it with necessary services.

Limco had no employees. To get the services it needed, a determination was made to outsource. Therefore, Limco hired Mr. Jones' firm, Gunnip & Company, as its accounting firm;

Mr. Black and his firm, Morris, Nichols, Arsht & Tunnell, as its legal counsel; and Mr. Colucci (who was not a Board member) as its trademark counsel. Limco also used Mr. Thompson as its liaison with the Wilmington Trust Company, the financial institution which provided financial and banking services. Gunnip & Company was also hired to provide administrative services such as answering telephones, opening mail and paying bills.

Lanco, V Secret, and Expressco

Lane Bryant and Victoria's Secret Stores were acquired by The Limited in 1982.

It was determined that the trademarks owned by Lane Bryant and Victoria's Secret Stores should receive the same level of protection that the mark "The Limited" was receiving.

Consideration of the same business and legal reasons that were weighed when Limco was established similarly led to the creation of Lanco and V Secret as separate trademark protection companies to protect the marks then owned by Lane Bryant and Victoria's Secret Stores, respectively.

Lanco was incorporated in Delaware on December 15, 1982 to protect the marks formerly owned by Lane Bryant. V Secret was incorporated in Delaware on November 1, 1983 to protect the marks formerly owned by Victoria's Secret Stores.

At the time of the formation of Lanco and V Secret, Lane Bryant and Victoria's Secret stores transferred certain trademarks to Lanco and V Secret, respectively, in exchange for 100 shares of the common stock of the respective trademark protection companies. Both of these exchanges were nonrecognition transfers under Internal Revenue Code § 351.

As with Limco, only the names under which Lane Bryant and Victoria's Secret Stores were operating (i.e., the names "over the door") were transferred to Lanco and V Secret. No secondary marks were transferred to Lanco or V Secret.

Express began as a division of Limited Stores and originally operated under the name "Limited Express". As the business of "Limited Express" started to become successful, the name of the business was changed to "Express". Express was incorporated as a separate

corporation and Expressco was subsequently incorporated in Delaware on September 9, 1987 to protect the mark "Express".

By an agreement dated September 10, 1987, Limco licensed certain trademarks to Expressco in exchange for 100 shares of Expressco common stock, $1.00 par value. This was a nonrecognition transfer under Internal Revenue Code § 351.

As with Limco, Lanco, and V Secret, only the name under which Express was operating, and no secondary marks, was transferred to Expressco.

Messrs. Black, Thompson, and Jones were retained by Lanco, V Secret, and Expressco to constitute three of each corporation's five Board members.

After Lanco, V Secret, and Expressco were formed, each company hired Mr. Black and his firm, Morris, Nichols, Arsht & Tunnell, as its legal counsel, Mr. Colucci as its trademark counsel, Gunnip & Company as its accounting firm, and Wilmington Trust Company for financial and banking services. Gunnip & Company also provided each company with administrative services, such as answering telephones, opening mail and paying bills.

Facts Not Contested in These Proceedings

For purposes of these proceedings only: (1) Limited Stores does not contest the Division of Taxation's ("Division") contention that it owned or controlled, either directly or indirectly, 80 percent or more of the voting stock of Limco during the fiscal years ending February 1, 1986 through January 28, 1989; (2) Lane Bryant does not contest the Division's contention that it owned or controlled, either directly or indirectly, 80 percent or more of the voting stock of Lanco during the fiscal years ending February 1, 1986 through January 28, 1989; (3) Victoria's Secret Stores does not contest the Division's contention that it owned or controlled, either directly or indirectly, 80 percent or more of the voting stock of V Secret during the fiscal years ending February 1, 1986 through January 28, 1989; and (4) Express does not contest the Division's contention that it owned or controlled, either directly or indirectly, 80 percent or more of the voting stock of Expressco during the fiscal years ending January 30, 1988 and January 28, 1989.

For purposes of these proceedings only: (1) Limited Stores does not contest the Division's contention that, under New York law, it was conducting a unitary business with Limco during the fiscal years ending February 1, 1986 through January 28, 1989; (2) Lane Bryant does not contest the Division's contention that, under New York law, it was conducting a unitary business with Lanco during the fiscal years ending February 1, 1986 through January 28, 1989; (3) Victoria's Secret Stores does not contest the Division's contention that, under New York law, it was conducting a unitary business with V Secret during the fiscal years ending February 1, 1986 through January 28, 1989; and (4) Express does not contest the Division's contention that, under New York law, it was conducting a unitary business with Expressco during the fiscal years ending January 30, 1988 and January 28, 1989.

The Licensing Agreements

Limco

At the initial meeting of the Board of Directors of Limco on January 29, 1981, Mr. Kenneth Gilman, a member of the board and also vice-president and treasurer of Limco and an officer of Limited Stores, Limco's parent, advised that the parent "had applied for the right to use the trademarks and service marks" of Limco, whereupon the board unanimously resolved to license Limco's marks to its parent for a royalty fee of 5% of gross sales pursuant to the terms of the "Related Company Agreement" which had been presented at said meeting.

Both Limited Stores and Limco's Board of Directors intended that Limco would license its marks to Limited Stores on an arm's-length basis -- i.e., that royalty rates charged on the marks would be considered arm's length rates.

An arm's-length relationship and substance were very important to Mr. Colucci, Limco's trademark counsel, because he was concerned that Limco might be accused of "naked licensing". (Tr., pp. 251-254.) According to Mr. Colucci, if an owner of a mark licenses the mark and does not maintain the nature and quality of the goods on which the mark is used by the licensee, the owner can be found to be engaged in naked licensing and the mark can be invalidated.

Mr. Colucci testified that due to the concept of naked licensing, Limco could not exist only in form, but had to exist in substance: it had to do everything a trademark owner normally does to maintain the quality of the services and the goods on which "The Limited" mark was used. If Limco did not do all this, it would risk losing the mark.

Mr. Colucci assisted in drafting the licensing agreement that Limco entered into with Limited Stores.

The agreement between Limco and Limited Stores was similar in form to hundreds of licensing agreements between unrelated parties that Mr. Colucci had previously drafted.

The licensing agreement was entered into as of February 1, 1981, and initially provided that Limited Stores would receive a nonexclusive license to use certain marks in exchange for a royalty fee of 5% of gross sales.

The licensing agreements between Limco and Limited Stores define gross sales (as do the licensing agreements between Lanco and Lane Bryant, V Secret and Victoria's Secret Stores, and Expressco and Express) to exclude such items as returned goods, and is therefore the same as what is generally considered to be net sales.

The licensing agreements between Limco and Limited Stores further provide that in case of a third-party infringement upon a trademark the licensee, Limited Stores, shall bear the cost of any legal action to prevent the continuation of such infringement. Any damages collected as a result of such legal action shall, after payment of expenses, belong to Limco. Additionally, the agreement provides that in the event either party is made party to a lawsuit based on an infringement claim, Limited Stores shall bear the cost to defend such claim.

After Limco and Limited Stores had entered into the licensing agreement as of February 1, 1981, Limited Stores retained Valtec Associates, Inc., an independent trademark valuation firm, to perform an analysis and valuation of the marks "The Limited" and "Limited Express".

Valtec Associates' report, dated July 15, 1981, indicated that the purpose of the study was "to determine an appropriate Fair Market Royalty Rate to associate with [the] tradenames [referred to above] for management purposes."

Valtec Associates concluded that the fair market royalty rate for "The Limited" trademark was 6.0% and that the fair market royalty rate for the "Limited Express" trademark was 5.5%.

The Valtec report indicates that a royalty rate depends, in part, upon the form and details of the licensing agreement. The report makes no reference to the licensing agreement already in place between Limco and Limited Stores. The report further states that "we have not made any assumptions regarding the structure of a hypothetical license . . . in respect to the services and obligations required of each party." The Valtec Associates analysis therefore did not include a review of the existing licensing agreement between Limco and Limited Stores.

The Valtec Associates study also compared, and to some extent, contrasted the Limco trademarks to the Calvin Klein label, while describing Klein as "the most appropriate analogy to the valuation of the subject assets."

Limco and Limited Stores amended the licensing agreement as of June 29, 1981 to provide for a royalty fee of 5.5% of gross sales for the use of the mark "Limited Express" and a royalty fee of 6.0% of gross sales for the use of the other marks licensed pursuant to the agreement.

Since the mark "The Limited" was both a service mark and a trademark, it was necessary for Limco to control the nature and quality of both the goods and services provided by Limited Stores.

Mr. Colucci devised a plan to protect the marks, which included regular inspections of the stores, during which a comprehensive checklist would be completed. Under this plan, inspections would be performed on a quarterly basis, with every store being inspected at least once a year. During an inspection an elaborate checklist would be completed.

The inspections noted above were performed by employees, specifically the district managers, of Limited Stores. The records of such inspections were maintained at the offices of Limited Stores. The inspection reports were reviewed semi-annually on behalf of Limco by employees of Gunnip & Company, Limco's accountants. The Gunnip & Company employee then reported the results of such review, along with copies of the inspection reports themselves, to Limco with copies sent to Mr. Colucci who received the report in his capacity as Limco's trademark counsel. Each of the Gunnip & Company employee's reports contained in the record advises Limco that inspection reports were reviewed and that such review indicates that all stores were inspected during each quarter according to the terms of the licensing agreement and that all stores were in compliance "in all material aspects" with the licensing agreement.

Lanco, V Secret and Expressco

The Boards of Directors of Lanco, V Secret, and Expressco, along with the retailers associated with such trademark company, i.e., Lane Bryant, Victoria's Secret Stores and Express, intended that each company would license its marks at arm's-length rates to Lane Bryant, Victoria's Secret Stores, and Express, respectively.

Mr. Colucci drafted licensing agreements between Lanco and Lane Bryant, V Secret and Victoria's Secret Stores, and Expressco and Express, modeled on the licensing agreement between Limco and Limited Stores.

Except for the amount of the royalty fee, the terms of the licensing agreements between Limco and The Limited Stores, Lanco and Lane Bryant, V Secret and Victoria Secret Stores, Expressco and Express are, in all material aspects, identical.

The licensing agreement between Lanco and Lane Bryant was entered in to as of January 5, 1983. The licensing agreement set a royalty fee of 0.1% of gross sales.

Lanco's Board of Directors ratified the Lanco-Lane Bryant licensing agreement by an action taken without meeting as of January 10, 1983.

During the September 24, 1985 meeting of the Board of Directors of Lanco, the royalty rate was discussed. The Board ratified the engagement of independent appraisers, Valtec Associates, to ascertain the then current fair market value of the trademark "Lane Bryant".

The Valtec Associates report, dated October 18, 1985, estimated a fair market royalty rate for the Lane Bryant tradename of 6.5%.

The Valtec report indicates that its estimate was based on contacts with sources in the women's fashion industry and in the business of licensed merchandising. The Valtec report further indicates that it did not review the existing agreement between Lanco and Lane Bryant.

During late 1985, the vice president and treasurer of Lanco, Timothy B. Lyons, wrote a letter to Lane Bryant dated December 9, 1985, advising that the appraisal by Valtec Associates had concluded that a market royalty rate for the Lane Bryant trademark would be 6.5%, and proposing (A) an early termination of the agreement then in place (which otherwise expired in mid-1987), and (B) an increase in the royalty rate to 5.5%, effective February 2, 1986, in lieu of the rate that would be set if a new royalty rate were negotiated in 1987.

By letter also dated December 9, 1985, Lane Bryant, after analyzing the proposal, agreed to the change in the royalty rate charged by Lanco.

Lanco entered into a renegotiated license agreement with Lane Bryant as of February 2, 1986. In this license agreement Lanco, in accordance with the above discussed negotiations, licensed its marks to Lane Bryant for a royalty equal to 5.5% of gross sales.

It is noted that the renegotiated license agreement was executed on behalf of Lane Bryant by Timothy B. Lyons, the same individual who had proposed the terms of the renegotiated agreement on behalf of Lanco.

As noted previously, Victoria's Secret transferred certain trademarks to V Secret in exchange for shares of V Secret stock. Specifically, pursuant to an Assignment of Trademark, dated January 26, 1987 and effective as of December 31, 1986, Victoria's Secret transferred one trademark to V Secret. Additionally, pursuant to an Assignment of Marks, dated March 31, 1988 and deemed effective as of December 31, 1986, Victoria's Secret transferred nine

additional marks to V Secret. The March 31, 1988 assignment indicates that it had been the intent of both the assignor and assignee as of December 31, 1986 to transfer all marks similar to Victoria's Secret to the assignee.

By agreement dated January 1, 1987, V Secret entered into a licensing agreement (hereafter referred to as the "Victoria's Secret licensing agreement" or the "1/1/87 licensing agreement") with Victoria's Secret Stores, under which the latter was granted a nonexclusive license to use one trademark ("Victoria's Secret") in return for a royalty rate of 5.5% of gross sales. On October 22, 1987, V Secret entered into "Amendment No. 1" to the 1/1/87 licensing agreement, which amendment authorized Victoria's Secret Stores to sublicense a certain service mark. The parties again amended the 1/1/87 licensing agreement to include additional trademarks by an "Amendment No. 2". "Amendment No. 2" recites that it is being entered into on January 1, 1987, notwithstanding that "Amendment No. 1" was entered into on October 22, 1987.

Limco initially licensed the trademark "Limited Express" to Expressco in return for 100 shares of Expressco's stock, by an agreement dated September 10, 1987. By a licensing agreement, also dated September 10, 1987, Expressco granted a nonexclusive license to Limited Stores to use the trademark "Limited Express" in return for a royalty of 5.5% of gross sales. It is noted that this rate is consistent with the fair market royalty estimates of Valtec Associates (see, Finding of Fact "44"). By agreement dated January 4, 1988, the Expressco-Limited Stores licensing agreement was terminated. Expressco then entered into a new licensing agreement, this time with Limited Express, Inc., dated January 4, 1988, whereby Express was granted a nonexclusive license to use the trademark "Limited Express" in return for a 5.5% royalty based on gross sales. By Amendment No. 1 to that agreement, effective March 16, 1988, the original agreement was amended to include the trademark "Express".

The inspection system used by Lanco, V Secret, and Expressco was similar to that used by Limco.

Additionally, the inspection system for Lanco, V Secret, and Expressco was implemented in the manner previously described herein (see, Finding of Fact "50").

As noted previously, the licensing agreements between the retailers and the trademark protection companies are essentially identical except for the royalty rates. The agreements are all nonexclusive. The agreements are either for a five-year period (Victoria's Secret Stores, Lane Bryant, Express) or ten-year period (Limited Stores), with an automatic right to renew for the same period. They permit the retailers to use the trademarks anywhere in the world.

Apart from the payment of royalties, the duties imposed on the retailers include the following: (1) the retailer must use its best efforts and skills in the operation of the stores and to insure the quality of the merchandise; (2) conduct inspections of each of its stores annually and to submit the reports to the trademark corporation; (3) submit samples of all advertising to the trademark corporation; (4) allow itself to be subject to an audit by the trademark corporation in order to verify the retailer's actual revenues.

The licensing agreements impose the following duties on the trademark corporations: (1) when requested by the retailer, the trademark corporation must make application for the registration of the retailer as a permitted or registered user of the transferred trademarks; (2) the trademark corporations must use "reasonable efforts" to register and maintain the trademarks throughout the world.

The consolidated Federal income tax returns of The Limited group indicate royalty income for the trademark corporations during the years at issue as follows:

FYE	Limco	Lanco	V Secret	Expressco
2/1/86	50,578,370	377,465	0	---
1/31/87	67,847,603	27,364,358	799,619	---
1/30/88	75,166,349	32,198,972	13,403,222	0
1/28/89	66,182,400	38,547,389	4,206,295	25,631,757

The Limited group's consolidated Federal income tax returns indicate royalty payment deductions for the retailer corporations during the years at issue as follows:

FYE	The Limited Stores	Lane Bryant	Victoria's Secret Stores	Express
2/1/86	49,603,000	377,465	0	---
1/31/87	66,350,448	25,328,451	799,619	---
1/30/88	78,707,125	32,198,972	13,556,773	993,844
1/28/89	64,377,052	38,546,721	16,065,452	25,631,757

The Loan Agreements

At the initial meeting of Limco's Board of Directors on January 29, 1981, the board resolved both to license its trade marks at 5% and to lend money to Limited Stores at a rate not less than the prime rate of the Wilmington Trust Company, Wilmington, Delaware.

Similarly, pursuant to its Action Taken Without Meeting By Directors as of January 10, 1983, the directors of Lanco authorized both the licensing of trademarks and loans to related corporations.

V Secret became an active corporation in late 1986. At its December 9, 1986 board meeting, the directors first authorized loans to related corporations.

Expressco's board of director's organizational meeting occurred on September 10, 1987. At a meeting held on December 1, 1987 the board authorized loans to related entities.

Limco, Lanco, V Secret and Expressco each lent funds to The Limited Stores, Lane Bryant, Victoria's Secret Stores and Express, respectively.

Generally, the loans were made pursuant to formal written 180-day promissory notes, which contained such standard provisions as the loan amount, date, interest rate, due date, and names of the parties.

Throughout the period at issue, the respective boards of directors of Limco, Lanco, V Secret and Expressco authorized loans to related corporations at a rate not less than the prime rate charged by the Wilmington Trust Company. The promissory notes issued pursuant to the intercompany loans made by the trademark corporations were consistent with this authorization.

Whenever a loan was issued by one of the trademark companies, the Wilmington Trust Company prime rate on the date of the loan was used as the interest rate for the loan.

The Wilmington Trust Company's prime rate was the rate at which the bank would lend

funds to its best and most creditworthy customers.

An example of the relative return provided by the prime rate was demonstrated by the Division's Exhibit "G" (Standard & Poor's Statistical Service, Basic Statistics, Banking and Finance) which reveals that the prime rate charged by banks on March 7, 1986 was 9%, while the interest rate on certificates of deposit in March 1986 was 7.24%, the interest rate on bankers' acceptances in March 1986 was 7.09%, and the commercial paper rate in March 1986 was 7.08%.

Apart from the promissory notes, Limco also entered into a revolving credit agreement for up to $50,000,000, which was an unsecured line of credit until it was converted to a term loan on June 30, 1985.

All of the intercompany loans were unsecured.

The record does not establish the manner in which the retailers repaid the loans from the trademark corporations. According to the testimony of Roger Thompson, the retail corporations repaid loans in cash and rolled loans over. It is noted that of the 27 intercompany promissory notes contained in the record only two, a March 20, 1985 note made by Lane Bryant, and a March 20, 1985 note made by Limited Stores, are stamped paid.

Operation of the Trademark Companies During the Years at Issue

Protection of the Marks

As noted previously, to insure that the marks were being adequately protected so that the trademark companies would not be considered to be engaged in naked licensing, inspections of the stores using the marks were performed on a quarterly basis, with every store being inspected at least once a year (see, Findings of Fact "49" and "50"). The elaborate checklist created by Mr. Colucci was used to perform these inspections.

Both the respective trademark companies and Mr. Colucci received and reviewed written reports of the inspections semi-annually.

The record herein contains semi-annual reports of inspections of The Limited Stores, Lane Bryant and Victoria's Secret Stores. All of these reports indicate that there were no problems with the retailer under the licensing agreements (see, Finding of Fact "50").

Part of Mr. Colucci's function as trademark counsel was to advise the appropriate trademark company and to insure that appropriate corrective action was taken if the inspection reports indicated problems with the retailers under the licensing agreements.

The licensing agreements also required the retailers to provide the trademark companies with copies of their advertising. As part of his duties Mr. Colucci inspected the in-store advertising of the retailers. This was done by reviewing a "label book" containing copies of all labels to be used by the retailers during a season.

Mr. Colucci performed his review of the retailers' in-store promotions as trademark counsel for the respective trademark company in the same manner as he reviewed such promotions when he was in-house counsel for Playtex.

Protection of the Marks from Infringement and for Future Expansion

Each trademark company held itself out as the owner and protector of its respective marks. To insure that the marks would be protected from infringement and to permit future expansion, the trademark companies registered the marks they owned in numerous countries outside of the United States.

To accomplish this the trademark companies and Mr. Colucci implemented an international system of registration. Initially, the trademark companies, with Mr. Colucci's assistance, established a priority for the foreign registrations: first, to register the marks in Canada and Mexico, the countries bordering the United States; second, to register the marks in countries where goods that used the marks were being manufactured; third, to register the marks in countries where future expansion was anticipated; and finally, to register the marks in countries where counterfeiting of marks frequently occurred.

Pursuant to this priority system, the trademark companies' marks were registered in numerous foreign countries. Mr. Colucci would first get authorization from the trademark

company to file an application for registration of the mark. Without such authorization (and a power of attorney demonstrating such authorization) from the trademark company, Mr. Colucci could not file an application for registration in a foreign country.

Mr. Colucci, with the assistance of a worldwide network of associates, would then file applications for registration of the marks in a given country on behalf of the respective trademark company.

In all instances, it was the trademark company that was Mr. Colucci's client.

The record does not establish, however, petitioners' assertion that each respective trademark company paid its own fees in connection with the registration of marks. Specifically, a review of the Federal income tax returns reveals a minimum level of deductions for legal fees for Lanco, V Secret and Expressco. In fact such fees would appear to cover little more than Mr. Black's fees for corporate legal services (see, Findings of Fact "19" and "30"). Such deductions appear to be inconsistent with the large numbers of registrations and oppositions involving these companies which are in evidence herein. It is noted that Limco's deductions for legal fees for the period at issue were substantial in amount.[1]

If the application for registration was granted, the country's licensing board would issue a certificate of registration listing the trademark company as the registered owner of the mark and providing in which class (or classes) of goods the mark was so registered. Examples of the hundreds of registrations received by the trademark companies were submitted into the record herein.

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[1]Specifically, the consolidated Federal income tax returns filed by The Limited group indicate that the trademark companies claimed the following deductions for legal fees during the years at issue:

	FYE 2/1/86	FYE 1/31/87	FYE 1/30/88	FYE 1/28/89
Limco	$70,346.00	$61,350.00	$199,938.00	$165,879.00
Lanco	3,423.00	2,400.00	2,928.00	3,957.00
V. Secret	2,550.00	2,502.00	2,502.00	1,261.00
Expressco	--	--	888.00	0

As the registration of a mark is for only a limited duration, Mr. Colucci informed each trademark company on a quarterly basis which registrations were about to expire and inquired whether any action should be taken by him to extend protection.

In addition to representing the trademark companies for the registration of their marks, Mr. Colucci also represented the companies with respect to oppositions, which are objections to the registration of a particular mark on the basis that it is similar to a previously existing registered mark, and which usually are initially prosecuted in an administrative proceeding. Oppositions can arise in two ways: first, a person could object to the registration of one of the trademark companies' marks; second, one of the trademark companies could object to the registration of another person's mark. Mr. Colucci represented the trademark company in both types of oppositions.

The latter situation arises when it is discovered that an application has been filed for registration of a mark similar to a previously registered mark of a trademark company. Information concerning such an application was obtained from numerous sources, including watching services (which use a computer to compare registered marks with marks for which an application has been filed). It was a part of Mr. Colucci's services to monitor all such sources.

When Mr. Colucci learned of such an application, he would go to the trademark company and ask for its permission to oppose the application. Mr. Colucci needed the authorization of the trademark company before he could proceed. Examples of the "hundreds and hundreds of oppositions and cancellations" that were brought by the trademark companies in foreign countries were discussed during the hearing and others are reflected in exhibits entered into evidence herein.

In addition to registering their marks in foreign countries, the trademark companies registered their marks in the United States with the U.S. Patent and Trademark Office. As in foreign countries, the trademark companies filed oppositions opposing the registration of similar marks by other persons.

Mr. Colucci also assisted the trademark companies in numerous lawsuits against infringers. These lawsuits were all brought by the trademark companies and involved suits in the United States as well as foreign countries.

To assist the trademark companies in keeping track of the voluminous number of civil litigations, including oppositions and cancellations, Mr. Colucci prepared litigation reports for each of the trademark companies.

In the 14 years since the formation of Limco, as a direct result of the protection efforts implemented by the trademark companies, none of the marks of the trademark companies have ever been successfully challenged anywhere in the world. Indeed, the licensing agreements have been produced in discovery in lawsuits and have been scrutinized by some of the finest intellectual property law firms, and there has never been a decision sustaining a challenge to the marks.

Regular Board of Directors and Shareholders' Meetings

Limco, Lanco, V Secret, and Expressco each held quarterly Board of Directors meetings in Delaware during the years in issue. The Board of Directors for each company was identical and board meetings for the four trademark companies were held at the same time with one following after another. Prior to each such meeting, notices were sent to remind the Board members of the meeting.

At the Board of Directors meetings, issues were discussed and decisions were made concerning the respective trademark company. These decisions involved increasing the amount of money the trademark companies were authorized to lend to affiliated corporations and problems with the inspection reports and other, more routine topics.

The meetings of the trademark companies were held at the offices of Mr. Black, a board member who was also legal counsel to each of the companies.

Minutes of these meetings were prepared by Mr. Black and reviewed by the other Board members.

In addition to actions taken at the Board meetings, the directors would review various documents in between such meetings.

Each trademark company also held annual stockholders meetings in Delaware. As with the meetings of the Boards of Directors, notices were sent prior to the meetings and minutes of each meeting were prepared for each company.

Other Activities of the Trademark Protection Companies

In addition to hiring Mr. Colucci as special trademark counsel, each trademark company retained the legal services of Mr. Black and his law firm, Morris, Nichols, Arsht & Tunnell, to assist it with its nontrademark legal matters. The services provided by Mr. Black and his law firm included maintaining each corporation's records (such as its minutes, certificate of incorporation, and bylaws) and making sure that each corporation maintained its good corporate form. Invoices for the services rendered were sent to each of the trademark companies by the law firm.

Each trademark company retained the services of Gunnip & Company to assist it with its accounting related matters. The services provided by Gunnip & Company included the preparation of quarterly financial reports (which were used at the board meetings), bookkeeping, and other necessary accounting services. Gunnip & Company also reviewed store inspection reports for the trademark companies (see, Finding of Fact "50"). Gunnip & Company invoiced each company for the services it provided. (See, Findings of Fact "19" and "30".)

During the years in issue, the trademark companies maintained office space in Wilmington, Delaware -- initially at 2625 Concord Pike, and subsequently at 1403 Foulk Road, Foulkstone Plaza. The offices of Gunnip & Company were located at the same addresses during the period at issue. Each of the trademark companies paid for its office space.

The lease documents for the four trademark companies are identical and each lease describes rentable space of 84.6 square feet at a nominal annual rental. Each company had

standard office equipment, including computers, fax machines, desks, chairs, and file cabinets, in the offices.

Each trademark company had its own letterhead, and its own telephone number, listed in the telephone directory under the company's name. The phone bills for each company were nominal.

Limco, Lanco, V Secret, and Expressco each maintained a checking account with the Wilmington Trust Company, used by each company to pay its respective expenses. These expenses included registration fees, telephone bills, and the invoices each company received for the services rendered by Gunnip & Company, and Morris, Nichols, Arsht & Tunnell.

Each trademark company also maintained its own separate custodial account with Wilmington Trust Company.

Petitioners' Expert Witnesses

Coopers & Lybrand

Petitioners submitted into evidence a report prepared by the international accounting firm of Coopers & Lybrand, which was explained by the testimony of Stanley Sherwood, a partner at Coopers & Lybrand. Mr. Sherwood was qualified at the hearing as an expert in accounting with expertise in transfer pricing under the standards of Internal Revenue Code § 482 ("Section 482"). The report summarized the results of a transfer pricing audit performed by Coopers & Lybrand under the supervision of Mr. Sherwood. The purpose of the transfer pricing audit was to analyze whether the relationships between each retailer and the respective trademark company during the years in issue met the arm's-length standards of Section 482. It was the intent of Coopers & Lybrand that the transfer pricing audit of each retailer and the respective trademark company be performed in the same manner that the Internal Revenue Service ("I.R.S.") would have performed such an audit.

The crux of Coopers & Lybrand's report and Mr. Sherwood's testimony is that (1) the trademark companies were separately viable legal entities with economic and business substance, (2) each retailer and the respective trademark company conducted their businesses on

an arm's-length basis, and (3) had the I.R.S. examined the relationships between each retailer and the respective trademark company, it would not have made an adjustment under Section 482.

In performing its transfer pricing audit, Coopers & Lybrand performed a functional analysis -- a fact-finding process that examines the related parties to determine each entity's functions, risks, and responsibilities -- of the retailers and the trademark companies to obtain an understanding of the facts and the overall relationship between each retailer and the respective trademark company. This analysis included meeting with the officers of the trademark companies, reviewing the minutes of the trademark companies, reviewing the license agreements and the loan agreements, and examining the financial agreements of the companies. As a result of the functional analysis, Mr. Sherwood and his staff determined that the retailers were significant operating units with significant operations. They also concluded that each of the trademark companies was a viable bona fide company with significant responsibilities and obligations to protect its assets.

Coopers & Lybrand then applied the Section 482 regulations to the instant case.[2] Coopers & Lybrand applied the Section 482 regulations concerning transfers of intangible property (Temp Treas Reg § 1.482-4T) to the licensing agreements between each retailer and the respective trademark company and determined that the royalties paid by each retailer to the respective trademark company were arm's length. In arriving at this conclusion, Coopers & Lybrand applied the comparable uncontrolled transaction ("CUT") method of the Section 482 regulations (Temp Treas Reg § 1.482-4T[c]). The CUT method compares transactions (i.e., actual agreements) between related parties with similar transactions between unrelated parties. Comparing the licensing agreements at issue in the instant matter with the third-party licensing agreements obtained and deemed comparable, Coopers & Lybrand found that the royalty rates charged by the trademark companies fell within the range of arm's-length rates. Mr. Sherwood

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[2]Whether such regulations were properly applied for purposes of this determination is discussed in Conclusions of Law "I" through "M".

therefore concluded that the royalty rates charged by the trademark companies were arm's-length rates, and that had the I.R.S. audited the transactions, it would not have made any Section 482 adjustments.

In its CUT analysis, the Coopers & Lybrand report listed seven licensing agreements each of which was deemed comparable to the Limited Stores, Lane Bryant and Express licensing agreements. The seven comparable agreements were identified as follows with the following royalty rates:

Licensing Agreement	Royalty Rate
Slazenger	4.0%
McGregor (Stage II)	5.0%
McGregor (Top Seed)	5.0%
Tijuca Sweaters	6.0%
Liz Claiborne	6.0%
Calvin Klein	7.5%
Pierre Cardin	8.5%

The Coopers & Lybrand report indicated that it did not review the Liz Claiborne, Calvin Klein and Pierre Cardin licensing agreements. The report further indicated that Coopers & Lybrand was unable to verify whether the Tijuca Sweaters, Liz Claiborne, Pierre Cardin or Calvin Klein licensing agreements were executed with unrelated parties.

The Coopers & Lybrand report indicates that the Slazenger agreement granted an exclusive license. The report provides no information regarding whether the remaining licensing agreements were exclusive or nonexclusive.

The Coopers & Lybrand report did not discuss the effect on the royalty rate of an exclusive or nonexclusive agreement; the effect of geographic limitations; or licensor vs. licensee obligations with respect to infringements.

With respect to the Liz Claiborne agreement, the report indicates that Liz Claiborne entered into nine licensing agreements with respect to a variety of products, one of which was women's apparel. The report states that the royalty rates on these agreements ranged from 4% to 8% and that, therefore, 6% was determined to be the "average" Liz Claiborne rate. The

report also indicates that Pierre Cardin and Calvin Klein entered into licensing agreements with a range of royalty rates.

With respect to Victoria's Secret Stores' licensing agreements, the report listed the following comparables and royalty rates:

Licensing Agreement	Royalty Rate
Ratner	5.0%
American Greeting	8.0%
New York Wholesale Distributors	5.0%

The report indicated that Coopers & Lybrand had not reviewed any of the three licensing agreements deemed comparable to the Victoria's Secret Stores' agreement.

In an effort to confirm the accuracy of its analysis under the CUT method, Coopers & Lybrand applied a second method under the Section 482 regulations, the comparable profits ("CPM") method (Temp Treas Reg §§ 1.482-4T[a][2]; 1.482-5T), to the licensing agreements. This method looks at the financial performance of the taxpayer in question and compares that performance to the financial performance of unrelated companies that are performing similar functions. After screening thousands of corporations, those deemed most comparable to each retailer were used for purposes of the CPM method. The operating profits of each retailer were compared with the constructive operating profits of the comparable companies. Although only one financial ratio (called a profit level indicator) is required for purposes of the CPM method, two different ratios were used. The specific ratios used in the CPM analysis were the ratio of operating profit to operating assets (rate of return) and the ratio of operating profit to sales. In computing the operating profits of the comparable companies under both ratios, certain adjustments were made in an effort to insure the comparability of the information. Specifically, the Coopers & Lybrand report indicates that three such adjustments were made. These adjustments seek to account for differences between the retailers and the comparables in inventory turnover rates, accounts payable levels, and accounts receivable levels. The financial ratios for each retailer were computed after the payment of royalty fees to the respective trademark company. The results of both these analyses were that the operating profits of each

retailer after the payment of the royalties fell within the arm's-length range and that, therefore, had the I.R.S. performed a Section 482 audit, it would not have made any adjustments.

The Coopers & Lybrand report indicated a total of seven corporations deemed comparable to petitioners. Of these, four were used in each of the CPM analysis for the respective petitioners. Some of the comparables were used in more than one CPM analysis. Each of the seven corporations selected as a comparable was a specialty women's apparel retailer, although each comparable's specialty niche in the women's apparel industry was somewhat different from the others' and from that of the respective petitioners. Additionally, among other similarities, each corporation selected as a comparable had a large geographic base and, with one exception, operated well over 100 stores.

In addition to analyzing the licensing agreements under Section 482, Coopers & Lybrand also analyzed the loan agreements between the trademark companies and the retailers under Section 482. Comparing the safe harbor rates contained in the Section 482 regulations concerning intercompany loans (Temp Treas Reg § 1.482-2T[a][2]) to the interest rates charged by the trademark companies, Coopers & Lybrand determined that the rates charged by the trademark companies in all cases fell within the safe harbor. Coopers & Lybrand therefore concluded that the interest rates charged by the trademark companies were arm's-length rates pursuant to Section 482.

As a result of Coopers & Lybrand's analysis, Mr. Sherwood testified that it was his opinion that the retailers and the trademark companies conducted their businesses on an arm's-length basis, both in the case of intangibles and in the case of loans, and that if the I.R.S. were to examine all relationships between each retailer and the respective trademark company, it would not make an adjustment under Section 482.

Dr. Irving H. Plotkin

At the hearing, petitioners presented the testimony of Irving H. Plotkin, Ph.D., a vice president of Arthur D. Little, Inc., and submitted into evidence a report prepared by Dr. Plotkin. Dr. Plotkin has previously testified as an expert witness, and is frequently asked by the U.S.

government and sometimes by state governments to so testify on matters of taxes and antitrust. Dr. Plotkin currently assists the I.R.S. in performing Section 482 audits. Dr. Plotkin was qualified at the hearing as an expert in econometrics with recognized expertise in transfer pricing under the standards of Section 482.

Dr. Plotkin's testimony and report concluded that the royalty fees charged under the licensing agreements between each retailer and the respective trademark company were arm's length under the standards of Section 482.

Dr. Plotkin testified that he reviewed the royalties paid by the retailers to the trademark companies for evidence, or lack of evidence, of adherence to the arm's-length standard (i.e., whether unrelated parties with adverse interests would be willing to enter into such a licensing agreement and pay the same royalty fee). To test whether or not the royalties were at arm's length, Dr. Plotkin used the learning he had acquired through assisting the Treasury Department and the I.R.S. in writing some of the Section 482 regulations, testifying in court cases concerning Section 482, and discussions among taxpayers, attorneys, and economists who are concerned with Section 482. Dr. Plotkin testified that the retailers were paying arm's-length royalties for the use of intangible rights; that intangible rights can be and are valued every day; that whole sections of the Internal Revenue Code, I.R.S. regulations, and multiple court cases would not exist if this were not so.

In analyzing the nature of the royalties paid by the retailers, Dr. Plotkin applied the rate of return test. Dr. Plotkin compared the rates of return of each retailer after it paid the royalties, with the rates of return earned by U.S. retailers generally, both individually for the years in issue and averaged over a longer period of time. Based on the rates of return obtained by the retailers after payment of the royalties, Dr. Plotkin concluded that the royalties paid were arm's length under the standards of Section 482. Dr. Plotkin testified that under the licensing agreements the retailers, after paying the royalties, already "challenged the scale." (Tr., p. 531.) Dr. Plotkin further concluded that it was not economically reasonable to ask the retailers to earn more than they were already earning. "If a taxpayer . . . tried to make a showing that it would not have

adequate compensation unless it earned 60 percent, I think the taxpayer would be laughed out of court." (Tr., pp. 531-532.) "[T]he bottom line of the [Division's] adjustment is to demand a 60 percent rate of return from The Limited [Stores], and that is a very, very healthy demand indeed." (Tr., p. 532.)

After hearing Dr. Plotkin's direct testimony that in his opinion -- as an expert in econometrics with recognized expertise in transfer pricing under the standards of Section 482 -- the royalties paid by the retailers to the trademark companies were at arm's length, and that the adjustments asserted by the Division were not economically reasonable, the Division's counsel asked Dr. Plotkin no substantive questions concerning his conclusions on cross examination. Moreover, when the Division's expert witness, Ronald Ginsberg, testified, he made no attempt to challenge the conclusions reached by Dr. Plotkin.

Dr. Ashwinpaul C. Sondhi

At the hearing, petitioners presented the testimony of Ashwinpaul C. Sondhi, Ph.D., a visiting associate professor at Georgetown University, and submitted into evidence a report prepared by Dr. Sondhi. Dr. Sondhi was qualified at the hearing as an expert in accounting and financial analysis.

Dr. Sondhi's testimony and report concluded that (1) there is a substantial economic rationale for the creation of the trademark companies and the use of the companies is an economically rational and viable business arrangement, and (2) the interest rates charged by the trademark companies to the retailers were arm's-length interest rates.

Dr. Sondhi determined that there are numerous reasons for the segregation into a separate company of an economically valuable asset that has the ability independently to generate cash flows (in this case, the marks). Reviewing the structure between the trademark companies and the retailers, Dr. Sondhi concluded that there is a substantial economic rationale for the creation of the trademark companies. Dr. Sondhi also concluded, based on his analysis of the post-formation operations of the trademark companies, that the use of the trademark companies is an economically rational and viable business arrangement.

Based on his review and analysis of the short-term notes and the revolving loan agreements (where applicable) between the trademark companies and the retailers, Dr. Sondhi concluded that the interest rates paid by the retailers to the trademark companies were arm's-length interest rates (which Dr. Sondhi defined as the rate that an independent lender would charge an unrelated independent borrower). In reaching his conclusion, Dr. Sondhi compared the loans made by the trademark companies to three different measures. Dr. Sondhi first determined that the interest rates charged by the trademark companies were equal to the prime rate charged by the Wilmington Trust Company at the time the loan was issued. Dr. Sondhi then compared the interest rates charged by the trademark companies to a nationwide monthly average of prime rates -- the same rates the retailers would have faced in the open market -- and found that the rates were equivalent. Since the interest rates paid by the retailers to the trademark companies were equal to the prime rate charged by the Wilmington Trust Company at the time of each loan, and since the rates were similar to the rates prevailing in the financial marketplace as they were equivalent to the nationwide monthly average prime rate, Dr. Sondhi concluded that the interest rates charged by the trademark companies reflected arm's-length transactions. As a third test, Dr. Sondhi compared each retailer's interest expense as a percentage of average total debt (i.e., its cost of borrowing funds) with the cost of borrowing funds faced by four companies deemed comparable by Dr. Sondhi to the Retailers. Comparing the interest expense percentage of each of the retailers with the interest expense percentages faced by the comparable companies, Dr. Sondhi concluded that the rates paid by the retailers were similar to those found in the open marketplace.

Richard W. Genetelli

At the hearing, petitioners presented the testimony of Richard W. Genetelli, founder and president of Genetelli & Associates, and submitted into evidence a report prepared by Mr. Genetelli. Mr. Genetelli was qualified at the hearing as an expert in accounting.

The crux of Mr. Genetelli's testimony and report is that the net income reported by each retailer on its respective separate company corporation franchise tax reports filed during the

years in issue fairly reflected the income generated by that company in New York during that year.

Mr. Genetelli's conclusion was based on a separate accounting analysis of the retailers for the years in issue, to test whether the reports filed by each retailer with New York properly reflected the income attributable to the State. This separate accounting analysis consisted of first examining numerous documents, including tax returns filed by the retailers and workpapers, and engaging in numerous conversations and attending meetings with representatives of the retailers to obtain an understanding of each retailer's activities. At these meetings, Mr. Genetelli also verified the accuracy of the documentation he reviewed. Based on this analysis, Mr. Genetelli then determined the amount of net income attributable to New York for each of the retailers for each of the years in issue. In performing his analysis, Mr. Genetelli was consistent and used the same approach for each retailer.

In computing each retailer's net income attributable to New York, Mr. Genetelli used specific geographical numbers when they were available. New York gross receipts and the bulk of the expense items were based on actual New York information. For expenses where actual New York figures were not available, Mr. Genetelli, based on his years of experience in the accounting field, used a reasonable approximation to attribute an appropriate amount of the expense to New York. In such situations, Mr. Genetelli attempted to give a fair reflection of the expenses attributable to New York.

Mr. Genetelli concluded that the amounts reported by each retailer were consistent with the amounts obtained from his analysis and that the reports as filed properly reflected each retailer's net income attributable to New York. Mr. Genetelli also concluded that were the Division's required combinations accepted, the amounts of income attributed to New York would be significantly greater than the income actually earned by the retailers in the State. In Mr. Genetelli's opinion, the separate reports filed by the retailers do not distort their respective activities, business, income, or capital in New York, and combination is therefore inappropriate.

The Division's Expert Witness -- Ronald Ginsberg

At the hearing, the Division presented the testimony of Ronald Ginsberg, an economist employed by the Division as chief of transfer pricing, and submitted into evidence a report prepared by Mr. Ginsberg. Mr. Ginsberg was accepted as an expert in transfer pricing with a particular emphasis on the distortion requirement for New York combined reports.

Mr. Ginsberg stated that both explicit distortion and inherent distortion resulted from the relationships between the retailers and the trademark companies. The only examples of explicit distortion provided by Mr. Ginsberg were the royalty payments and the interest payments made by the retailers to the trademark companies. Mr. Ginsberg specifically acknowledged that the principles of Section 482 are relevant for purposes of determining the existence of distortion. In concluding that distortion existed in the instant case, however, Mr. Ginsberg did not analyze the royalty payments or the interest payments under Section 482.

Mr. Ginsberg testified that inherent distortion resulted from the unitary relationships between the retailers and trademark companies. Mr. Ginsberg also testified that in evaluating whether a loan is arm's length, all of the terms of the loan must be considered, not just the interest rate.

Mr. Ginsberg's report stated that distortion resulted from the transfer of trademarks, within a unitary business, from the retailers to the trademark companies because some of the flows of value between the two resulting corporate forms can be identified, such as royalty payments or interest rates, while other flows of value "which include the subtle inner workings within a business" are not susceptible to valuation. Mr. Ginsberg also testified that, under the instant circumstances, it was not possible to independently value the marks.

Dr. Plotkin addressed the issue of inherent distortion on rebuttal. Dr. Plotkin testified that "[d]istortion only arises under the circumstances if the price between the two parties is wrong. It doesn't arise from the nature." (Tr., pp. 637-638.) Dr. Plotkin further testified that Mr. Ginsberg's assertion that the unitary nature of the businesses creates distortion -- that

distortion must systematically arise -- is purely qualitative. Dr. Plotkin explained that distortion is a quantitative term and you cannot have distortion qualitatively.

On rebuttal, Dr. Plotkin also testified that it was absolutely not true that trademarks and other intangibles cannot be independently valued. Such assets can be, and regularly are, valued apart from the rest of an ongoing business.

The Audit

Limited Stores, Lane Bryant, Victoria Secret Stores, and Express each filed separate corporation franchise tax reports. Upon audit, the Division of Taxation concluded that (1) Limited Stores should have filed combined reports with Limco, (2) Lane Bryant should file combined reports with Lanco, (3) Victoria's Secret Stores should file combined reports with V Secret, and (4) Express should file combined reports with Expressco.

The field audit in these matters was conducted by Joan Kirkland of the Division's Buffalo District Office. On her first field visit to The Limited's Columbus, Ohio headquarters, she met with Bob Schaefer, controller for The Limited, and discussed petitioners' general mode of operations.

During the course of the audit, Ms. Kirkland asked petitioners to provide detail about expense items in The Limited's, Inc. and subsidiaries' consolidated Federal income tax returns for the years in the audit period. Specifically, she asked Mr. Schaefer for detail in regard to the "interest expense" and the "other deductions" items. From petitioners' responses to these inquiries and from her conversations with Mr. Schaefer she concluded that in the case of each, royalty payments constituted 100% of the royalty corporations' royalty income, and that the interest payments and royalty payments from the operational corporations, taken together, constituted 95% or more of the trademark corporations' income.

The Division's auditor testified at the hearing that she believed combined reports were necessary because each retailer was engaged in a unitary business with the respective trademark company, the ownership requirement for required combination was met, and there were substantial intercorporate transactions between the companies which gave rise to a presumption

of distortion. This testimony is consistent with the comments found in the audit reports.

According to the audit reports, the Division determined that Limco, Lanco, and V Secret were each "virtually a shell organization" and Expressco "is a shell and not a viable business in its own right.

The Division's auditor also stated that she did not believe that a company could transfer its name to another entity and then license the use of that name from that other entity. The auditor stated that she did not "believe that you can separate a company or a store from its name" (tr., p. 135). According to the auditor, since "the trademark protection company did nothing except sit there and collect money", she "didn't feel that it was a fair representation of the work of these companies to separate them. I thought they had to be combined." (Tr., p. 136.) This testimony is consistent with the comments found in the audit reports.

The audit reports further indicated that the royalty payment made by the retailers to the trademark companies resulted in distortion because the value of the trademarks resulted from the activities of the retailers. Such activities generated expenses that were deducted in prior years' calculation of New York income. To allow further deduction based on the capitalized value placed on these intangibles creates a distortion.

The auditor testified that she did nothing to ascertain the validity of her assumption that the trademark companies "did nothing except sit there and collect money" (tr., p. 136). For example, she did not interview Mr. Black or Mr. Jones, or any other director of the trademark companies. Nor did she interview Mr. Colucci, or learn about the numerous activities the trademark companies continuously engaged in to protect their respective marks. Indeed, the Division's auditor admitted that she had no personal knowledge of what the trademark companies did.

In proposing that each retailer should be forced to file combined reports with the respective trademark company, Ms. Kirkland did not analyze the royalty rates charged under the licensing agreements to determine whether the rates were arm's length under Section 482.

Nor did Ms. Kirkland analyze the interest rates charged by the trademark companies to determine if they constituted arm's length rates under Section 482.

Ms. Kirkland explained her lack of analysis as to whether the royalty rates or interest rates charged by the trademark companies were arm's-length rates on the basis that she "didn't feel that arm's length could be determined based on what I saw the company operating as." (Tr., p. 147.)

Petitioners presented no expert reports similar to those in evidence herein during the course of the field audit to support their contention that the intercorporate transactions at issue were at arms length.

As a result of the field audit, on May 3, 1991 notices of deficiency asserting additional corporation franchise taxes and metropolitan business tax surcharges were issued to the respective petitioners as follows:

a) The Limited Stores, Inc.

Assessment Number	Period Ended	Tax Amount Assessed	Interest Amount Assessed	Total Amount Assessed
C910503100F	1/31/89	$ 401,867.00	$100,486.00	$ 502,353.00
C910503101S	1/31/89	12,786.00	3,197.00	15,983.00
C910503102F	1/31/88	444,768.00	163,953.00	608,721.00
C910503103S	1/31/88	18,596.00	6,855.00	25,451.00
C910503104F	1/31/87	380,725.00	181,914.00	562,639.00
C910503105S	1/31/87	20,891.00	9,982.00	30,873.00
C910503106F	1/31/86	213,065.00	132,308.00	345,373.00
C910503107S	1/31/86	5,271.00	3,273.00	8,544.00
		$1,497,969.00	$601,968.00	$2,099,937.00

b) Lane Bryant, Inc.

Assessment Number	Period Ended	Tax Amount Assessed	Interest Amount Assessed	Total Amount Assessed
C910503108F	1/31/89	$ 543,190.00	$135,824.00	$ 679,014.00
C910503109S	1/31/89	58,133.00	14,536.00	72,669.00
C910503110F	1/31/88	497,140.00	183,259.00	680,399.00
C910503111S	1/31/88	53,421.00	19,692.00	73,113.00
C910503112F	1/31/87	330,850.00	158,083.00	488,933.00

C910503113S	1/31/87	27,146.00	12,971.00	40,117.00
C910503114F	1/31/86	6,154.00	3,821.00	9,975.00
C910503115S	1/31/86	560.00	348.00	908.00
		$1,516,594.00	$528,534.00	$2,045,128.00

c) Victoria's Secret Stores, Inc.

Assessment Number	Period Ended	Tax Amount Assessed	Interest Amount Assessed	Total Amount Assessed
C910503116F	1/31/89	$106,116.00	$26,534.00	$132,650.00
C910503117S	1/31/89	6,096.00	1,524.00	7,620.00
C910503118F	1/31/88	97,051.00	35,776.00	132,827.00
C910503119S	1/31/88	7,516.00	2,771.00	10,287.00
C910503120F	1/31/87	8,950.00	4,276.00	13,226.00
C910503121S	1/31/87	759.00	363.00	1,122.00
C910503122F	1/31/86	3,456.00	2,146.00	5,602.00
		$229,944.00	$73,390.00	$303,334.00

d) Express, Inc.[3]

Assessment Number	Period Ended	Tax Amount Assessed	Interest Amount Assessed	Total Amount Assessed
L0061851293	1/31/89	$179,126.00	$ 72,803.26	$251,929.26
	1/31/89	9,911.00	4,028.36	13,939.36
	1/31/88	49,179.00	26,549.27	75,728.27
	1/31/88	3,409.00	1,840.74	5,249.74
		$241,625.00	$105,221.63	$346,846.63

As reported on their franchise tax reports for many of the years at issue, petitioners made overpayments of franchise tax to be applied to the subsequent year's liability.

Michigan's Single Business Tax

A portion of the subject deficiencies involved the addback, for New York corporation franchise tax purposes, of Michigan's single business tax for petitioners herein. This issue was resolved by agreement between the parties (see, Petitioners' brief, Exhibit "1", Letter dated

[3]The Express, Inc. Notice of Deficiency was issued on August 10, 1992 and, unlike the notices issued to the other petitioners, said notice was issued under one assessment number.

October 7, 1994 from Craig B. Fields, Esq., to James P. Connolly, Esq., and schedule attached thereto).

Proposed Findings of Fact

Petitioners submitted proposed findings of fact numbered "1" through "122". Of these, the following proposed findings of fact are, in substance, accepted and have been incorporated into the record herein: "1" through "12", "14", "17", "19", "21" through "27", "31", "33", "34", "36" through "38", "41", "43" through "47", "49", "51", "53", "54", "60", "64" through "68", "70" through "87", "89", "91", "95" through "97", "99", "101", "102", "104", "106" through "108", "111", "114" through "119". In some instances, stylistic changes have been made in these accepted proposed findings of fact. Additionally, references to the record have been deleted.

The following proposed findings of fact have been modified:

(a) Proposed finding of fact "13" (see, Finding of Fact "14"): "Since the purpose of Limco . . ." changed to "Since one of the purposes of Limco . . ." to better reflect the record.

(b) Proposed finding of fact "15" (see, Finding of Fact "16"): Characterization of the professionals and institutions listed therein deleted as irrelevant and as unsupported by the record.

(c) Proposed finding of fact "16" (see, Finding of Fact "17"): Delete "and therefore they were 'outside' directors" as said term is not defined in the hearing transcript and constitutes a legal conclusion.

(d) Proposed finding of fact "18" (see, Finding of Fact "19"): Delete first sentence as unsupported by the record as Limco corporate minutes gives no indication that consideration was given to retaining full-time employees. Delete "to get the best people for the job" as unsubstantiated.

(e) Proposed finding of fact "20" (see, Finding of Fact "21"): Delete "It was believed that the trademarks . . . would eventually become very valuable." Phrase "very valuable" is vague and record indicates such marks were already valuable at that time.

(f) Proposed finding of fact "28" (see, Finding of Fact "34"): Substitute "intended" for "determined" to more accurately reflect the record. Add "Both the Limited Stores, Inc. and" to more accurately reflect the record.

(g) Proposed finding of fact "29" (see, Finding of Fact "35"): Add to second sentence "According to Mr. Colucci" to more accurately reflect the record.

(h) Proposed finding of fact "30" (see, Finding of Fact "36"): Add "Mr. Colucci testified that" to more accurately reflect the record.

(i) Proposed finding of fact "32" (see, Finding of Fact "38"): Delete "drafted in the same manner" and add "was similar in form" to more accurately reflect the record.

(j) Proposed finding of fact "35" (see, Finding of Fact "42"): Delete "To insure that the royalty rates . . . were arm's length . . ." and add "After Limco and The Limited Stores . . . The Limited Stores retained". The purpose of the Valtec report is set forth in said report (see, Finding of Fact "43").

(k) Proposed finding of fact "39" (see, Finding of Fact "49"): Delete fourth sentence. Finding of Fact "50" more accurately describes the manner by which the inspection reports were reviewed.

(l) Proposed finding of fact "40" (see, Finding of Fact "51"): Add "along with the Retailers associated with each such Trademark Company" to more accurately reflect the record. Delete "determined" and add "intended" to more accurately reflect the record.

(m) Proposed finding of fact "42" (see, Finding of Fact "54"): Delete "At that time Lane Bryant was not a successful business" and "appropriate" as unsubstantiated.

(n) Proposed finding of fact "48" (see, Finding of Fact "65"): Delete "arm's length rate" and add "fair market royalty estimates" to more accurately reflect the record.

(o) Proposed finding of fact "50" (see, Finding of Fact "77"): First sentence rejected; second sentence accepted. Corporate minutes do not indicate that the boards of the trademark companies considered the lending of funds to related entities the "safest and most prudent approach" (see, Findings of Fact "73" through "76").

(p) Proposed finding of fact "52" (see, Finding of Fact "79"): The minutes of the board meetings in the record do not support the assertion that trademark companies boards specifically mandated "arm's length" rates. This portion of proposed finding is therefore rejected. Additionally, the minutes and documentation do not support the assertion in the proposed finding that the interest rates were "negotiated". Clearly, the captive trademark companies agreed to or ratified loan agreements proposed by officials of the Limited group.

(q) Proposed finding of fact "55": Rejected. This proposed finding was based on the opinion of Mr. Thompson. Mr. Thompson testified that his expertise was not commercial lending (tr., p. 196). Mr. Thompson was therefore not qualified to render an opinion on the creditworthiness of the retailers.

(r) Proposed finding of fact "56": Rejected. Since Mr. Thompson did not have commercial lending expertise, his "recommendation" is irrelevant.

(s) Proposed finding of fact "57": Rejected. The "type" of loans at issue are intercompany loans within a controlled group of corporations. There is no evidence that Wilmington Trust ever made such loans. The proposed finding is thus irrelevant.

(t) Proposed finding of fact "58": Rejected. Minutes of trademark companies' board meetings do not support assertion that other investments considered.

(u) Proposed finding of fact "59" (see, Finding of Fact "82"): Substitute "relative" for "superior" to better reflect the record.

(v) Proposed finding of fact "61" (see, Finding of Fact "87"): Substitute "semi-annually" for "every quarter" to reflect the record.

(w) Proposed finding of fact "62" (see, Finding of Fact "89"): None of the inspection reports in the record indicate any problems uncovered (see, Finding of Fact "88"). First sentence is thus rejected; second sentence modified.

(x) Proposed finding of fact "63" (see, Finding of Fact "90"): No documentation in record indicating that trademark companies were contacted regarding the in-store promotions. Second sentence of the proposed finding is thus rejected.

(y) Proposed finding of fact "69" (see, Finding of Fact "96"): " . . . and the application fee was paid . . . Company" rejected (see, Finding of Fact "97").

(z) Proposed finding of fact "88" (see, Finding of Fact "118"): Delete ". . . and Mr. Colucci". Unsupported by the record (see, Finding of Fact "97").

(aa) Proposed finding of fact "90" (see, Finding of Fact "120"): Fourth sentence add "The purpose of", "was to" and fifth sentence add "It was the intent of Coopers & Lybrand that" to better reflect the record.

(bb) Proposed finding of fact "92" (see, Finding of Fact "122"): Delete "very detailed" and "detailed" to better reflect the record.

(cc) Proposed finding of fact "93" (see, Finding of Fact "123"): Add footnote "2". Delete ". . . since a considerable . . . existed" from second sentence and add "deemed comparable" to the fourth sentence since the merits of the Coopers & Lybrand report are properly discussed in Conclusions of Law.

(dd) Proposed finding of fact "94" (see, Finding of Fact "131"): Add "In an effort" and "deemed". The merits of the analysis properly discussed in Conclusions of Law.

(ee) Proposed finding of fact "98" (see, Finding of Fact "136"): Delete "reconfirmed" and add "concluded" to better reflect the record.

(ff) Proposed finding of fact "100" (see, Finding of Fact "138"): Delete "arm's length" from first sentence as conclusory.

(gg) Proposed finding of fact "103" (see, Finding of Fact "141"): Delete "reconfirmed" and add "concluded" to better reflect the record.

(hh) Proposed finding of fact "105" (see, Finding of Fact "143"): With respect to the sixth sentence, delete "companies engaged in the same business" and add "four companies deemed comparable by Dr. Sondhi" to better reflect the record. Merits of Sondhi report discussed in Conclusions of Law.

(ii) Proposed finding of fact "109" (see, Finding of Fact "147"): Delete "was conservative" and add "attempted to give" (fourth sentence) to better reflect the record.

(jj) Proposed finding of fact "110" (see, Finding of Fact "148"): Delete "forced" and add "required".

(kk) Proposed finding of fact "112" (see, Finding of Fact "150"): First sentence delete "in his opinion" as redundant. Second sentence delete "arm's length" as conclusory. Fourth sentence delete "purportedly" as redundant and delete "or challenge the arm's length status" as redundant. Sixth sentence rejected as unsupported by the hearing transcript. Seventh sentence rejected since Mr. Ginsberg did assert that the royalty payments and loans were examples of distortion.

(ll) Proposed finding of fact "113" (see, Finding of Fact "151"): Delete "claimed", substitute "testified" and delete "allegedly" to better reflect the record.

(mm) Proposed finding of fact "120" (see, Finding of Fact "162"): Fifth sentence rejected as irrelevant; otherwise accepted.

(nn) Proposed finding of fact "121" (see, Finding of Fact "163"): Second sentence rejected as irrelevant; otherwise accepted.

(oo) Proposed finding of fact "122" (see, Finding of Fact "164"): Second sentence rejected as unsupported by the record; otherwise accepted.

SUMMARY OF THE PARTIES' POSITIONS

(a) Petitioners assert that the evidence presented establishes that the trademark companies were economically viable entities and that there were numerous business and legal reasons for creating such companies.

(b) Petitioners assert that the evidence presented establishes that the transactions between the retailers and their respective trademark affiliates were at arm's length pursuant to the regulations and principles of Internal Revenue Code § 482 and that petitioners have thereby rebutted the presumption of distortion flowing from the existence of substantial intercorporate transactions. Accordingly, petitioners assert that they may not be required to file combined franchise tax reports.

(c) More specifically, petitioners assert that the Sondhi report establishes that the interest rates on the intercompany loans were consistent with market rates. Petitioners further assert that the Coopers & Lybrand report establishes that such interest rates fell within the safe harbor provisions of the Section 482 regulations.

(d) Petitioners further contend that the Coopers & Lybrand report establishes that the royalty rates between petitioners and their trademark affiliates were arm's-length rates under the Section 482 regulations. Petitioners note that the Coopers & Lybrand report conducted two methods of analysis (CUT and CPM) and contend that either method proved that the royalty rates were arm's length under the regulations.

(e) Petitioners also contended that the Plotkin rate of return analysis established that the royalty rates were arm's length pursuant to the principles of Section 482.

(f) Petitioners also contended that the separate accounting analysis of Mr. Genetelli established that the net income as reported in the separate corporation franchise tax reports filed by petitioners for the years at issue fairly reflected the income generated by that company in New York during those years. Petitioners assert that this report further establishes that if petitioners are required to file combined reports with their trademark affiliates, the amounts of income attributed to New York would be significantly greater than the income earned in New York.

(g) With respect to Issue II, petitioners assert that since certain petitioners made overpayments of corporation franchise tax for many of the years at issue, and since those overpayments were credited to subsequent years' tax liability, then to the extent of such overpayments interest on the deficiencies should begin to accrue from the date the overpayment was credited to the subsequent year's liability.

(a) After noting that the stock ownership and unitary business prerequisites to combined reporting have been met, and the conceded existence of substantial intercorporate transactions between petitioners and their respective trademark affiliates, the Division asserts that petitioners have failed to rebut the presumption of distortion flowing from such transactions by a showing

that the intercorporate transactions between petitioners and their trademark affiliates were at arm's length.

(b) The Division asserts that the following three types of intercorporate transactions present in the instant matter distort petitioners' income: (1) petitioners' transfer of their "crown jewel" trademarks to the trademark corporations; (2) the agreements under which the trademark corporations licensed the trademarks; and (3) the intercompany loans.

(c) The Division further asserts that the relationships between petitioners and their respective trademark affiliates were so seamlessly integrated that "inherent distortion" results. Accordingly, an arm's-length relationship between the corporations cannot exist (Division's brief, pp. 48-50).

(d) The Division's "inherent distortion" argument appears to rest on the report and testimony of Mr. Ginsberg. Pursuant to this report and testimony, the Division asserts that a tradename consists of aspects which cannot be separated from the legal trademarks. These inseparable aspects, the "aura" of the tradename, consist of customer goodwill, customer records and mailing lists, important retail locations, exclusive products that are sharply differentiated from the competition, and vendor relations (Division's brief, p. 66).

(e) The Division further contends that the expert testimony and reports submitted by petitioners were flawed and therefore insufficient to establish that the intercorporate transactions between petitioners and their affiliated trademark corporations were at arm's length. Specifically, the Division contended that the Coopers & Lybrand reports' CUT analysis was flawed because (1) the report failed to verify that all of the alleged comparable transactions were uncontrolled and (2) the report failed to prove that the alleged comparable transactions were, in fact, comparable to the licensing transactions at issue.

(f) Similarly, the Division contended that the Coopers & Lybrand reports' CPM analysis failed to establish "the comparability of the comparables" (Division's brief, p. 93) under the Section 482 regulations. Other flaws in the CPM analysis, according to the Division, were: its reliance on "incommensurate and unverified financial information" (Division's brief, p. 98);

its failure to "take into account that petitioners were receiving valuable services from The Limited's support corporations, including The Limited Service Corporation" (Division's brief, p. 100); and the report's failure to "account for the fact that at least one of the petitioners, Limited Stores, Inc., had 'valuable, non-routine intangibles' in the form of trademarks" which, according to the Division, would prohibit the use of the CPM method with respect to this petitioner.

(g) The Division asserts that the Plotkin report is flawed because the rate of return analysis employed therein is not among the methods enumerated in the regulations under Section 482. The Division deems the Plotkin report to be a CPM analysis and, as such, the Division asserts that the analysis fails because of a lack of comparables. Other shortcomings in the Plotkin report, according to the Division, are: its alleged use of industry averages; a failure to adequately explain the source of the information used to calculate the rate of return; a failure to consider the services received from other Limited Group subsidiaries; and a failure to consider that Limited Stores owned other intangibles.

(h) The Division also noted that none of the reports submitted by petitioners analyzed the transfer of the trademarks from the retailers to the trademark companies. The Division asserted that such transactions were not arm's length and thus resulted in distortion.

(i) With respect to the Genetelli separate accounting analysis, the Division asserts that such an analysis cannot accurately portray the income of a unitary business spanning multiple jurisdictions (Division's brief, p. 111). The Division further asserts that the Genetelli report assumes that petitioners' royalty expenses are proper and thereby assumes a point that must be proven by petitioners.

(j) With respect to the intercompany loans, the Division asserts, through the report and testimony of Mr. Ginsberg, that both the Sondhi and the Coopers & Lybrand reports are flawed in that said reports did not consider the terms and conditions of the loans other than the interest rate.

(k) Also, as noted previously, the Coopers & Lybrand report concluded that the interest rates on the intercompany loans fell within the safe harbor provisions of the Section 482 regulations. The Division asserts that the safe harbor provisions should not be controlling since such provisions do not consider any terms and conditions of a loan other than the interest rate.

(l) The Division also asserts, generally, that other methods of valuation could have been undertaken without reference to Section 482. The Division listed three of these methods but did not introduce any valuation studies of its own.

(m) With respect to Issue II, the Division asserts that, under Tax Law § 1086(b), an overpayment claimed as a credit against estimated tax for the succeeding year may not subsequently be allowed as a credit or refund for the year for which the overpayment arises.

(a) In reply, petitioners assert that the Division's "inherent distortion" theory runs contrary to the established legal principles governing combined reporting.

(b) Petitioners also contend that the Division's theory of "aura" distortion is invalid and asserts that tradenames are regularly transferred among corporations.

(c) Petitioners further assert that a determination of the arm's-length nature of intercorporate transactions is properly made by application of the Section 482 standard and that there has been no showing that any non-482 valuation study would be superior to a 482 analysis.

(d) Petitioners further contend that, contrary to the Division's position, distortion does not result from transfers of intangible property where no gain is recognized (i.e., section 351 nonrecognition transfers).

(e) Petitioners further contend that the Division's attacks on the Coopers & Lybrand, Plotkin, Genetelli and Sondhi reports all fail.

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a tax on foreign corporations doing business in New York State (Tax Law § 209[1]). In order to properly reflect that tax liability, Tax Law § 211(4) gives the Division the discretion to require or permit corporations subject to New York

State tax to file combined reports with certain other corporations. The statute requires that the parent own or control substantially all of the stock of the subsidiary. The statute further limits the Division's discretion by providing that:

> "no combined report covering any corporation not a taxpayer shall be required unless the [Division] deems such a report necessary, because of inter-company transactions . . . in order properly to reflect the tax liability" (Tax Law § 211[4]).

B. The Division's regulations provide that the Division may require or allow the filing of a combined report where three conditions are met: (1) a stock ownership test (20 NYCRR 6-2.2[a]); (2) a unitary business test (20 NYCRR 6-2.2[b]); and (3) a distortion of income test (20 NYCRR 6-2.3). The distortion of income test provides, in part, that the Division:

> "may permit or require a group of taxpayers to file a combined report if reporting on a separate basis distorts the activities, business, income or capital in New York State of the taxpayers. The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations" (20 NYCRR 6-2.3[a][emphasis added]).

C. The presumption of distortion is one that can be rebutted by the taxpayer by showing that the transactions between the corporations are at arm's length (see, Matter of USV Pharm. Corp., Tax Appeals Tribunal, July 16, 1992 [use of Federal section 482 adjustments appropriate to show arm's-length pricing]; Matter of The New York Times Co., Tax Appeals Tribunal, August 10, 1995; Matter of Standard Mfg. Co., Tax Appeals Tribunal, February 6, 1992; see also, Matter of Sears, Roebuck & Co., Tax Appeals Tribunal, April 28, 1994; Matter of Campbell Sales Co., Tax Appeals Tribunal, December 2, 1993 [the Tribunal will apply section 482 principles in the absence of Federal section 482 adjustments]).

D. In the instant matter, the stock ownership and unitary business requirements have been met. Accordingly, the question presented is whether petitioners have rebutted the presumption of distortion.

E. Internal Revenue Code § 482 provides as follows:

> "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses,if he

> determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible."

Viability of the Trademark Companies

F. During the course of the audit and at the hearing, the Division questioned the legitimacy and viability of the trademark companies. This is an important point, for if no business justification exists for the trademark companies -- if such companies were, in fact, "shells" -- then clearly any royalty or interest payments to such companies would result in distortion and combined reports would be necessary to properly reflect petitioners' income.

The record in this matter is clear in establishing that the trademark companies were viable corporations, each of which was engaged in the registration and protection of the trademarks it owned. The testimony of Mr. Colucci established the legal necessity of trademark protection by the trademark companies to protect their assets. The documentation in the record establishes the extensive activities of the trademark companies through Mr. Colucci with respect to the protection and registration of the marks. The record, including the Coopers & Lybrand and Sondhi reports, also indicates numerous other business reasons for choosing to create a trademark company, e.g., limited liability, anti-takeover device, centralized system to manage the marks. Furthermore, the documentation in the record establishes that, during the period at issue, the trademark companies maintained good corporate form and operated not only through Mr. Colucci, but through regular shareholders' and board of directors' meetings.

In its brief, the Division appears to have softened its position regarding the viability of the trademark companies, stating:

> "[T]he Division does not doubt that many business justifications exist for The Limited's decision to use the royalty corporations; it would merely assert that an additional economic reason for setting up royalty corporations in Delaware was tax avoidance" (Division's brief, p. 23).

In response to this assertion, petitioners correctly note that tax ramifications are properly considered with respect to "all business transactions as a matter of ordinary business prudence" (Petitioners' reply brief, p. 11; see, G. D. Searle & Co. v. Commr., 88 TC 252, 365). The existence of such tax considerations does not, however, negate or supercede the existence or validity of other business and economic justifications for a particular transaction (id.).

Inherent Distortion

G. The Division's argument that the retailers and their trademark affiliates were "so seamlessly integrated with one another so as to defy any attempt to ascertain the existence of an arm's length relationship" (Division's brief, p. 48) is rejected. As petitioners correctly note in their reply brief (pp. 11-13), this argument amounts to an assertion that, at least under certain circumstances, the existence of a unitary business relationship must result in distortion and the filing of combined reports. In other words, under certain circumstances, the presumption of distortion is irrebuttable. The recent line of Tribunal decisions on the issue of combined filing very clearly establishes that the presumption of distortion arising from the existence of a unitary business and substantial intercorporate transactions may be rebutted by a showing of an arm's-length relationship between the related corporations (see, Conclusion of Law "C").

Distortion and Nonrecognition Transfers

H. The Division's assertion that the nonrecognition transfers of the trademarks to the trademark companies result in distortion is also rejected. As petitioners correctly note, nonrecognition transfers have been present in prior Tribunal cases involving combination and at no time have such transfers been cited as a factor in establishing the existence of distortion (see, Matter of USV Pharm. Corp., supra; Matter of Mohasco Corp., Tax Appeals Tribunal, November 10, 1994). Second, the nonrecognition transfers present in this case, i.e., trademarks exchanged for 100% of the trademark corporation's stock, were arm's-length transfers since the value of a corporation's stock is, by definition, equal to its assets (see, Eli Lilly & Co. v. Commr., 856 F2d 855, 866, 88-2 US Tax Cas ¶ 9502). It seems illogical to conclude that distortion results from such a transaction. Additionally, Federal cases upon which the Division

relies are distinguishable from the instant matter. Specifically, in both Central Cuba Sugar Co. v. Commr. (198 F2d 214, cert denied 344 US 874) and Rooney v. United States (305 F2d 681) the courts found an artificial separation of income and expenses resulting from nonrecognition transfers. There has been no showing of such a mismatching of income and expenses herein. Moreover, although, as the Division correctly notes, the Tax Court has found on one occasion that a transfer of intangibles to a corporation pursuant to Internal Revenue Code § 351 may result in the distortion of the transferor corporation's income (see, G.D. Searle & Co. v. Commr., supra), the Court of Appeals' decision in Eli Lilly & Co. v. Commr. (supra) rejected the Tax Court's rationale in Searle, and this rationale is similarly rejected herein.

Coopers & Lybrand Report

I. As noted previously, in an effort to rebut the presumption of distortion, a report was prepared by Coopers & Lybrand which sought to analyze the intercompany transactions between the retailers and trademark affiliates in accordance with the regulations promulgated under Internal Revenue Code § 482.

The Coopers & Lybrand report applied the temporary 482 regulations issued in 1993. The final regulations were published in 1994. The Coopers & Lybrand report sought to determine whether the royalty rates charged by the trademark companies were arm's-length rates by using the comparable uncontrolled transaction ("CUT") method and the comparable profits ("CPM") method. These two methods are specified in the regulations as available methods to determine the arm's-length character of a controlled transfer of intangible property (Temp Treas Reg § 1.482-4T[a]). As their names imply, the basic idea of both methods is to compare controlled transactions or entities with uncontrolled transactions or entities.

As the Division correctly notes, "[k]ey to both . . . [methods] is the concept of comparability" (Division's brief, p. 80). The regulations list five factors to be considered in determining the comparability of the controlled and uncontrolled transactions and entities. These factors are:

(1) A functional analysis of the economically significant activities of the controlled and uncontrolled taxpayers;

(2) An analysis of the risks borne in the controlled and uncontrolled transactions;

(3) A comparison of the significant contractual terms governing the controlled and uncontrolled transactions;

(4) A comparison of the economic conditions under which the controlled and uncontrolled transactions take place; and

(5) A comparison of the property or service involved in the controlled and uncontrolled transaction (see, Temp Treas Reg § 1.482-1T[c]).

The temporary regulations further provide that, with respect to transfers of intangible property, "an uncontrolled transaction is comparable to a controlled if it involves comparable intangible property and takes place under comparable circumstances" (Temp Treas Reg § 1.482-4T[c][2][ii]) and list the following factors to be considered in determining comparability:

> "Factors to be considered in determining comparability -- (A) Comparable intangible property. The intangible property involved in an uncontrolled transfer will be considered comparable to the intangible property involved in the controlled transfer if both intangibles --
>
> "(1) Are in the same class of intangibles, as defined under paragraph (b) of this section;
>
> "(2) Relate to the same type of products, processes, or know-how within the same general industry or market; and
>
> "(3) Have substantially the same profit potential. For this purpose, the profit potential of an intangible is measured by the net present value of the benefits to be realized (based on prospective profits to be realized or costs to be saved) through the use or subsequent transfer of the intangible, taking into consideration the capital investment and startup expenses required, the risks to be assumed, and other relevant considerations.
>
> "(B) Comparable circumstances. In evaluating the comparability of the circumstances of the controlled and uncontrolled transactions, although all of the factors described in § 1.482-1T(c)(3) must be considered, specific factors that may be particularly relevant to this method include the following --
>
> "(1) The terms of the transfer, including the exploitation rights granted in the intangible, the exclusive or nonexclusive character of any rights

granted, any restrictions on use, or any limitations on the geographic area where the rights may be exploited;

"(2) The stage of development of the intangible (including, where appropriate, necessary governmental approvals, authorizations, or licenses);

"(3) Any rights to receive periodic updates or improvements to the intangible;

"(4) The uniqueness of the property and the period for which it remains unique, including the degree and duration of protection afforded to the property under the laws of the relevant countries;

"(5) The duration of the license, contract, or other agreement, and any termination or renegotiation rights;

"(6) Any economic and product liability risks to be assumed by the transferee;

"(7) The existence and extent of any collateral transactions or ongoing business relationships between the transferee and transferor; and

"(8) The functions to be performed by the transferor and transferee, including any ancillary or subsidiary services" (Temp Treas Reg § 1.482-4T[c][2][ii]).

The temporary regulations further provided that, generally:

"[f]or two transactions to be considered comparable, an uncontrolled transaction need not be identical or exactly comparable to the controlled transaction, but must be sufficiently similar that it provides a reasonable and reliable benchmark for determining whether the controlled transaction led to the arm's length result" (Temp Treas Reg § 1.482-1T[c][2][i]).

Not surprisingly, 482 regulations similar to that quoted above have been subject to a range of interpretations as to what qualifies as a "comparable" in any given case. The courts have cautioned the Internal Revenue Service against interpreting the term "comparable" as "identical" (see, e.g., Bauch & Lomb v. Commr., 933 F2d 1084, 1091). Accordingly, this determination shall attempt to give effect to the language set forth in the temporary regulations.

J. A review of the Coopers & Lybrand CUT analysis and the foregoing regulations compels the rejection of said analysis as proof that the royalty agreements between petitioners and their respective trademark affiliates were arm's length.

As noted previously, the key to this analysis is comparability and it is in the selection of the comparable where one finds significant flaws. First, as the Division correctly notes in its

brief, the Coopers & Lybrand CUT analysis did not examine the profit potential of the intangibles involved in the alleged comparable transactions (Division's brief, pp. 87-89). The temporary regulations specifically list profit potential as a factor to be considered in determining comparability (see, Temp Treas Reg § 1.482-4T[c][2][ii]; Conclusion of Law "I").

A second requirement of the regulations is an examination of the significant contractual terms (Temp Treas Reg § 1.482-1T[a]). The CUT analysis presented did not review the licensing agreements governing three of the alleged comparable uncontrolled transactions (Liz Claiborne, Pierre Cardin and Calvin Klein).

Moreover, even where the licensing agreements were reviewed, the Coopers & Lybrand CUT analysis did not discuss or evaluate certain significant contractual terms which appear relevant to the calculation of the royalty rates. Specifically, the analysis does not discuss the effect on the royalty rate of exclusive vs. nonexclusive agreements; the effect of geographic factors (i.e., worldwide rights vs. geographically limited rights); or licensor vs. licensee obligations with respect to infringements.

Additionally, the CUT analysis is flawed in that, with respect to the Limited Stores-Lane Bryant-Express comparables, the report could not verify whether the Tijuca Sweaters, Liz Claiborne, Pierre Cardin or Calvin Klein licenses were executed with unrelated parties. With respect to the Victoria's Secret stores comparables, the CUT report indicated that Coopers & Lybrand was unable to determine whether any of the three purportedly comparable licensing agreements were entered into with unrelated parties. Obviously, since the premise of the CUT method is to compare uncontrolled transactions, the failure to establish that the comparable transactions involved unrelated parties is a significant shortcoming.

The Coopers & Lybrand report also indicates that Liz Claiborne entered into nine licensing agreements with respect to a variety of products, one of which was women's apparel. The report indicates that these royalty rates had a range of 4% to 8%. The CUT analysis listed 6% as the comparable Liz Claiborne royalty rate and justified this figure as the "average" Liz Claiborne rate. This assertion is incorrect as 6% is not the average; rather, it is the midpoint in

a range of rates. Considering the lack of information regarding the distribution of the royalty rates along this range, the 6% figure is rendered meaningless.

Similarly, the Coopers & Lybrand report advises that Pierre Cardin and Calvin Klein entered into licensing agreements with a range of royalty rates. The lack of information regarding this range renders suspect the report's decision to select the midpoint of the range as the comparable royalty rate.

K. As noted, Coopers & Lybrand also performed a comparable profits (CPM) method of analysis. This method determines arm's-length consideration by reference to "objective measures of profitability" called "profit level indicators" which are derived from comparable uncontrolled taxpayers. "An arm's length range of results is determined based upon the amounts of profit that the tested party . . . would have earned if its profit level indicators were equivalent to those of the uncontrolled taxpayers" (Temp Treas Reg § 1.482-5T[a]).

Similar to the CUT method, the CPM requires a selection of comparables. However, the temporary regulations indicate that the degree of comparability required under the CPM is less than that required under the CUT method.

> "Selection of comparable parties -- (1) Comparability. The comparable profits method measures the total return on the business activities of a tested party. Therefore, the controlled and uncontrolled taxpayers need be only broadly similar, and significant product diversity and some functional diversity between the controlled and uncontrolled transactions is acceptable. However, the greater the similarity between the tested party and the comparable party, the more reliable is the measure of an arm's length result under this method" (Temp Treas Reg § 1.482-5T[c][1]).

Once comparables are selected, the CPM provides that certain adjustments may be made to the comparables' financial data. Such adjustments may include accounting reclassifications, or adjustments to the operating income or assets of the comparable to account for material differences with respect to functions and risks between the comparable and the controlled taxpayer (see, Temp Treas Reg § 1.482-5T[c][2]).

Where comparables are properly selected and adjustments are properly made pursuant to section 1.482-5T(c)(2), then the arm's-length range includes all the "constructive operating profits" (see below) derived from the comparables (Temp Treas Reg § 1.482-5T[d][2][i]).

Once comparables have been selected and appropriate adjustments made, the CPM requires that certain "profit level indicators" be calculated from the comparables' financial data. Profit level indicators are "financial ratios that measure relationships among profits, costs and resources employed" and which "may provide a reliable basis for comparing the operating profits of similar controlled and uncontrolled taxpayers" (Temp Treas Reg § 1.482-5T[e]).

Among the profit level indicators set forth in the regulations are the rate of return of capital employed (defined as the ratio of operating profit to operating assets) and the ratio of operating profit to sales (see, Temp Treas Reg § 1.482-5T[e][1], [2][i]). These were the profit level indicators employed by Coopers & Lybrand in its CPM analysis.

L. Upon review of the Coopers & Lybrand, CPM analysis, the testimony of Mr. Sherwood in support thereof and the relevant regulations as noted, it is concluded that the CPM analysis selected uncontrolled taxpayers that were comparable within the standards of Temp Treas Reg § 1.482-5T(c)(1); that the appropriate adjustments to the comparables were made pursuant to Temp Treas Reg § 1.482-5T(c)(2); that the arm's-length range under the CPM analysis was the range of all constructive operating profits derived from the comparable parties (Temp Treas Reg § 1.482-5T[d][2][i]); that the profit level indicators were appropriately applied (Temp Treas Reg § 1.482-5T[e]); that the application of such profit level indicators revealed that petitioners' profit levels fell within an arm's-length range; and that, therefore, by implication, the royalty rates at issue also fell within an arm's-length range.

M. Turning to the Division's objections to the CPM analysis (see, ¶ "172[f]"), specifically the Division's contention that the Coopers & Lybrand report failed to prove the comparability of the comparables, it is noted that the Division has offered no proof to show that the selection of such comparables was inappropriate. As indicated previously, based upon the information contained in the report, the comparables chosen appear reasonable. If the Division had information indicating otherwise, such information should have been offered. Similarly unavailing is the Division's objection to the financial data contained in the Coopers & Lybrand report. The record does not indicate that such data was "uncommensurate" or "unverified" as

the Division asserts, and the Division has offered no proof in support of this contention. Accordingly, the Division's allegation is properly rejected. The Division's assertion that the CPM analysis is flawed for its failure to account for petitioners' receipt of services from The Limited Service Corporation is also rejected. The record does not indicate that such services were performed on anything other than an arm's-length basis. Indeed, the record indicates that The Limited Service Corporation was audited at the same time as petitioners and yet this corporation was not included in any proposed combined group (see, Division's Exhibit "D").

The Division also contends that, with respect to Limited Stores, the CPM analysis is flawed because Limited Stores had valuable, nonroutine intangibles in the form of trademarks which prohibited the use of the CPM. The Division asserts that the "Outback Red" and "Forenza" trademarks constituted such intangibles.

With respect to this contention, the Division correctly notes that the temporary regulations indicate that the CPM would not be accurate where the tested party (i.e., Limited Stores) uses "valuable, nonroutine intangibles" (Temp Treas Reg § 1.482-5T[a]). However, the Division's assertion is refuted by petitioners, who point out that this term was not defined in the temporary regulations. Petitioners further note that attempts by commentators to ascribe a meaning to the term indicate that the term was meant to encompass only unique brands, without substitutes in the marketplace, and thereby excludes most trademarks (see, Petitioners' reply brief, p. 39). Petitioners further note that this restriction was eliminated with the enactment of the 1994 regulations.

Accordingly, it is concluded that the "Outback Red" and "Forenza" trademarks did not constitute "valuable, non-routine intangibles" within the meaning of the temporary regulations and the CPM analysis of Limited Stores.

Plotkin Report

N. The Plotkin report (discussed in Findings of Fact "135" through "139") clearly establishes that petitioners' respective rates of return after payment of royalties exceeded the rates of return experienced by most U.S. retailers during the period at issue. By inference, then,

the Plotkin report supports the proposition that the royalty rates paid by the retailers to their respective trademark affiliates were consistent with arm's-length rates.

An analysis similar to the rate of return analysis herein was conducted by Dr. Plotkin on behalf of the Internal Revenue Service in E. I. DuPont de Nemours and Co. v. U.S. (78-1 US Tax Cas ¶ 9374 [Ct of Claims 1978], findings adopted 608 F2d 445, 79-2 US Tax Cas ¶ 9633 [Ct of Claims 1979], cert denied 445 US 962, 64 L Ed 2d 237). The analysis performed by Dr. Plotkin in the DuPont case involved a study of the rates of return of over 1,100 companies. Both the trial and appellate level courts specifically note Dr. Plotkin's analysis as supportive of the Commissioner's reallocation of income under section 482.

The Division asserts that the Plotkin report was flawed because it was not among the methods listed in the 482 regulations. The Division further asserts that the Plotkin report most clearly resembles a CPM approach, but that the analysis was "hopelessly out of conformity with CPM requirements" (Division's brief, p. 104).

The Division's objections to the Plotkin report are rejected. Since the Plotkin report does not purport to be a CPM analysis, its conformity or nonconformity with CPM requirements is unimportant. What is important is whether the Plotkin report applies the principles of section 482, for the Tribunal has made very clear that it is guided by the principles of 482 in determining whether intercorporate transactions result in distortion (see, Matter of Sears, Roebuck & Co., supra).

Upon review of the expert testimony of Dr. Plotkin and the Plotkin report, and considering that a similar rate of return analysis was determined relevant and material by both the trial and appellate courts in DuPont (supra), it is concluded that the Plotkin report does apply the principles of section 482 and thus supports petitioners' contentions that the payment of royalties by petitioners did not distort their taxable income within the meaning of Tax Law § 211(4).

Interest Rates

O. Temp Treas Reg § 1.482-2T(a) provides rules for determining arm's-length interest on loans between controlled entities. The regulations require that the loans constitute bona fide indebtedness (Temp Treas Reg § 1.482-2T[a][1][ii]) and define arm's-length interest rate generally as follows:

> "For purposes of section 482 . . . an arm's length rate of interest shall be a rate of interest which was charged, or would have been charged, at the time the indebtedness arose, in independent transactions with or between unrelated parties under similar circumstances. All relevant factors shall be considered, including the principal amount and duration of the loan, the security involved, the credit standing of the borrower, and the interest rate prevailing at the situs of the lender or creditor for comparable loans between unrelated parties."

The regulations further provide for a "safe haven" interest rate for loans between members of a consolidated group so long as the lender is not in the business of making loans and the loan principal and interest is expressed in U.S. dollars (Temp Treas Reg § 1.482-2T[a][2][iii]). The temporary regulations define the safe haven interest rate as a rate not less than 100 percent or greater than 130 percent of the "applicable Federal rate" (id.). The applicable Federal rate depends on the terms of the loan (Temp Treas Reg § 1.482-2T[a][2][iii][C]). The government regularly updates the applicable Federal rates (see, Internal Revenue Code § 1274[d]).

The Coopers & Lybrand report establishes that the interest rates on the loans made by the trademark companies to the retailers fell within the safe haven range as provided for in the temporary regulations. The report thus indicates that the loans were made at arm's-length rates.

The Division's objections to the Coopers & Lybrand report's loan analysis, centered upon its contention that the safe haven provisions of the 482 regulations should not be used to determine the arm's-length nature of the interest rates at issue, is rejected. As noted previously, the Tribunal is guided by the principles of 482 (see, Matter of Sears, Roebuck & Co., supra). Clearly, the section 482 regulations apply the principles of section 482. The Division has offered no good reason why the 482 regulations on interest rates should not be applicable herein.

The Sondhi report also supports petitioners' position by helping to establish that petitioners did borrow at Wilmington Trust's prime rate and that Wilmington Trust's prime rate at the time was consistent with the prime rates of financial institutions generally. The Sondhi report's third test fails, however, as it did not establish the comparability of the chosen comparable companies (see, Finding of Fact "143").

Separate Accounting Analysis

P. The separate accounting analysis provides little support to petitioners' position herein. This report did not analyze the intercorporate transactions which are the subject of this dispute. As the Division correctly notes, the separate accounting analysis assumes that the royalty payments and the interest payments are arm's length and thereby assumes a point that must be proved by petitioners.

Issue I: Summary of Conclusions

Q. The foregoing Conclusions of Law establish the following: (1) the Coopers & Lybrand CPM analysis and the Plotkin report together establish that the royalties paid by the retailers to the trademark companies during the period at issue were arm's length; (2) the Coopers & Lybrand interest rate analysis establishes that the interest rates on the intercompany loans were arm's-length rates; (3) since the royalties and interest rates were at arm's length, petitioners have rebutted the presumption of distortion arising from the existence of a unitary business and substantial intercorporate transactions; (4) the Division has not established the existence of distortion in connection with either the royalties or the interest rates; and (5) accordingly, the Division may not require that petitioners file combined corporation franchise tax reports with their respective trademark affiliates.

Issue II: Computation of Interest With Respect to Overpayments

R. Tax Law § 1084(a) provides, in relevant part:

> "If any amount of tax is not paid on or before the last date prescribed in article . . . nine-a . . . for payment, interest on such amount . . . shall be paid for the period from such last date to the date paid, whether or not any extension of time for payment was granted."

In support of their position on Issue II (see, ¶ "171[g]"), petitioners cite Revenue Ruling

88-98 and the decision upon which the ruling is based, Avon Products v. United States (588 F2d 342). The Revenue Ruling holds that:

> "When a taxpayer claims an overpayment on a return filed on the original due date or on a return filed with an extension, and the claimed overpayment is applied in full against an installment of the next year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on that part of the deficiency that is equal to or less than the claimed overpayment and from the original due date on the remainder" (Rev Rul 88-98).

Inasmuch as the plain language of Tax Law § 1084(a) indicates that interest shall be computed from the last date prescribed for payment and makes no provision for overpayments, petitioners' contention is rejected. While it appears that under the Federal rule interest would properly be computed in accordance with petitioners' contention, I decline to follow the Federal rule. Considering the alternate status of this issue and prolixity, of this determination, no further discussion is warranted.

S. The petitions of Express, Inc., Lane Bryant, Inc., The Limited Stores, Inc. and Victoria's Secret Stores, Inc. are granted and the Division of Taxation is directed to modify the notices of deficiency dated May 3, 1991 and August 10, 1992 (see, Finding of Fact "166") in accordance with Conclusion of Law "Q" and Finding of Fact "168".

DATED: Troy, New York
September 14, 1995

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE