New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

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Corporation Tax
August 5, 2009

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C071227A

A petition dated December 21, 2007 requests an advisory opinion regarding how royalty receipts earned from the licensing of the Petitioner's intellectual property should be allocated to New York for purposes of determining the receipts factor of the business allocation percentage (BAP). The Petitioner's receipts will be allocated to New York based on where the activity that generates the licensee's fee occurs. In this case, the fee is generated where the products containing or using the Petitioner's intellectual property are sold.

Facts

The Petitioner is a corporation subject to the Article 9-A general business corporation franchise tax. The Petitioner owns and licenses artistic and literary intellectual property. A majority of the property is copyrighted or trademarked. The Petitioner and its corporate affiliates have developed the property and the Petitioner licenses this property to businesses (licensees) that manufacture, distribute and sell consumer products based on the Petitioner's intellectual property. The consumer products include clothing, home decorating items, toys, and fabrics. The Petitioner's receipts are derived primarily from the royalties charged for the licensing of this property.

The Petitioner's standard licensing agreement provides that royalties are calculated by multiplying the licensee's net sales of licensed products by a royalty rate percentage. Also, each licensee pays the Petitioner a minimum royalty guarantee. A portion of this guarantee is due at the time the agreement is signed and the balance is due as agreed to by the parties. The licensee may subcontract with third-party manufacturers for the actual manufacturing of the licensed products. Subcontractors are prohibited from sub-licensing or further subcontracting, and their relationships with the licensees cannot be on a royalty basis. No matter who manufactures the products, the royalties paid to the Petitioner are based on the net sales of the licensee.

Licensees are required to furnish the Petitioner with annual royalty reports detailing the licensee's net sales and projecting anticipated sales and future royalties. The Agreement requires the licensees to report sales on a retailer-by-retailer basis to the Petitioner and to maintain detailed, accurate, and complete records and books of account covering all transactions relating to the agreement. Retailers include national and international retailers.

Analysis

Section 210.3(a)(2) of the Tax Law provides the apportionment formula for purposes of computing the receipts factor of the BAP. The BAP is determined by dividing a taxpayer's New York business receipts by its total business receipts within and without New York. Receipts from the license to use the Petitioner's copyrighted property will be allocable to New York to the extent the use of the copyright occurs in New York. New York regulation § 4-4.4(c) provides that royalties include all

amounts received by a taxpayer for the use of a copyright, whether or not the copyright was issued to or is owned by the taxpayer. Also, a copyright is considered to be used in New York to the extent the activities relating to the use of the copyright are carried on in New York. Receipts from the license to use the Petitioner's non-copyrighted intellectual property will be allocated to New York State when the receipts are earned in New York. (20 NYCRR § 4-4.6).

Apart from the general rules above, there is no regulation that determines when the use of copyrighted property occurs in New York or where receipts from non-copyrighted intellectual property are earned. However, similar facts were presented to and addressed by the Administrative Law Judge in the *Matter of Disney* ALJ Determination No. 818378 (Feb. 12, 2004). The reasoning in that determination re-affirms the Department's interpretation of when the use of copyrighted property occurs in New York and where receipts from non-copyrighted intellectual property are earned.

In *Disney*, the taxpayer, through its consumer products business, licensed and distributed the name of Walt Disney, its animated character likenesses, and its visual and literary property, songs, and music to manufacturers worldwide. Disney's licensing activities generated royalties based on a fixed percentage of the wholesale or retail selling price of the licensee's products. Disney allocated its royalty receipts to New York if the licensee having the right to produce goods with Disney's characters or brands used a New York business location as its address in the licensing agreement. Disney sought to change its method of allocation by using the location of where the property containing the Disney characters or brands was manufactured.

The Administrative Law Judge rejected Disney's request to change its method of allocating receipts from royalty income to where the goods were manufactured and noted that the taxpayer's licensing fees were based upon a percentage of the licensee's net invoiced billings on sales. Significantly, the ALJ noted that if it was at all administratively practical, the location of the licensee's sales of goods would be a better way to allocate royalty income, because it would be more reflective of the geographic location of its economic activities, i.e., the sales, from which the taxpayer directly benefits. The ALJ further noted that it is not the manufacturing of goods that is relevant for determining the portion of royalty income to be allocated to New York when such income is based on the sales of such goods. No exception was taken on appeal regarding the allocation rule for royalty income.

As described above, the Petitioner's receipts are from licensing activities similar to those described in *Disney*. As in *Disney*, the licensees are paying royalties to the Petitioner because of the buying public's awareness of the Petitioner's intangible property on or in the licensees' products, and income is earned where those products are sold. Therefore, it is reasonable to apply the sourcing rule upheld in the *Disney* determination to the Petitioner's facts. The Petitioner's receipts from licensing its copyrightable property should be allocated in accordance with where the property is used. In this case, the property is used where the activity that generates the licensing fee occurs, that is, where the licensee sells the goods. Likewise, the Petitioner's receipts from licensing its non-copyrighted property will be allocated where the receipts from that property are earned. In this case, the Petitioner's receipts are also earned at the location where the licensee sells the property. Therefore, if the licensee sells the Petitioner's copyrighted and non-copyrighted intellectual property in New York, the Petitioner will allocate the royalties from that property to New York for purposes of determining its receipts factor. If the licensee

does not provide the Petitioner with a breakdown of the locations of its sales, it is appropriate for the Petitioner to allocate the royalties it receives to the billing address of the licensee.

DATED: August 5, 2009

/S/
Jonathan Pessen
Director of Advisory Opinions
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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.