STATE OF NORTH CAROLINA — BEFORE THE SECRETARY OF REVENUE

COUNTY OF WAKE

IN THE MATTER OF:	)	
	)	
The Proposed Corporate Franchise and Income Tax Assessments for Fiscal Years ending January 31, 1992 through January 31, 1994 by the Secretary of Revenue of North Carolina	)	**FINAL DECISION** DOCKET NO. 97-990
	)	
vs.	)	
	)	
[Taxpayers]	)	

An Administrative Hearing was conducted before Michael A. Hannah, Assistant Secretary of the North Carolina Department of Revenue, in the city of Raleigh on June 9 through June 11, 1998, regarding Notices of Tax Assessment proposed against [Taxpayers, Subsidiary Trademark Companies One through Nine]. The Taxpayers were represented by [three attorneys from an out-of-state law firm and one attorney from a North Carolina law firm]. The Corporate, Excise, and Insurance Tax Division of the Department of Revenue was represented by Jack L. Harper, former Director, Donna P. Powell, Administrative Officer, and Kay Miller Hobart, Assistant Attorney General, North Carolina Attorney General's Office.

ISSUES

The issues to be decided in this matter are as follows:

I. Are the Taxpayers "doing business" in this State within the meaning of G.S. 105-130.3 and G.S. 105-114 so as to be subject to the corporate income and franchise tax?

II. Are the Taxpayers “excluded corporations” within the meaning of G.S. 105-130.4(a)(4)?

EVIDENCE

The following items were introduced by the parties at or subsequent to the hearing as exhibits and made part of the record:

Submitted by the Department:

D-1(a) Spreadsheet summary of corporate income tax, interest, penalty, and total assessments for tax years 1/31/92, 1/31/93, and 1/31/94 for [the Taxpayers].

D-1(b) Spreadsheet summary of franchise tax, interest, penalty, and total assessments for tax years 1/31/92, 1/31/93, and 1/31/94 for [the Taxpayers].

D-1(c)(1) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Two].

D-1(c)(2) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Three].

D-1(c)(3) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Four].

D-1(c)(4) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Five].

D-1(c)(5) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Six].

D-1(c)(6) Notices of corporate income tax assessments, franchise tax assessments, field auditor’s report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company One].

D-1(c)(7) Notices of corporate income tax assessments, franchise tax assessments, field auditor's report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Seven].

D-1(c)(8) Notices of corporate income tax assessments, franchise tax assessments, field auditor's report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Eight].

D-1(c)(9) Notices of corporate income tax assessments, franchise tax assessments, field auditor's report, and audit worksheets for tax years 1/31/92, 1/31/93, and 1/31/94 for [Taxpayer, Subsidiary Trademark Company Nine].

D-2(a) Correspondence dated April 22, 1996 to Department of Revenue from [Taxpayers' attorney] protesting notices of tax assessment and requesting a consolidated tax hearing.

D-2(b) Correspondence dated September 15, 1997 to [Taxpayers' attorney] from Michael A. Hannah, Assistant Secretary of Revenue, reserving the week of June 8, 1998 for an administrative tax hearing.

D-2(c) Correspondence dated April 14, 1998 to [Taxpayers' attorney] from Michael A. Hannah, Assistant Secretary of Revenue, extending the dates for administrative hearing to include Friday, June 12, 1998.

D-3(a) Correspondence dated April 14, 1998 from Kay Miller Hobart, Assistant Attorney General, to [Taxpayers' attorney] concerning stipulations to a test company case.

D-3(b) Draft stipulation of [Related Retail Company Four & Taxpayer, Subsidiary Trademark Company Four] as "test case" by [Taxpayers' attorney] dated March 26, 1998.

D-3(c) Correspondence dated April 30, 1998 from [Taxpayers' attorney] to Donna Powell, Administrative Officer at the Department, responding to Departmental request for information dated April 15, 1998.

D-4(a) Correspondence dated April 15, l998 from Donna Powell, Administrative Officer, to [Taxpayers' attorney] requesting detailed factual information and other documents pertinent to facts and circumstances of protested issues.

D-4(b) Correspondence dated April 30, 1998 from [Taxpayers' attorney] to Donna Powell responding to Departmental request for information dated April 15, 1998.

D-4(c) Correspondence dated May 13, 1998 from Jack Harper, Director of the Department's Corporate, Excise, and Insurance Tax Division to [Taxpayers' attorney] requesting additional factual information pertinent to facts and circumstances of protested issues.

D-4(d) Correspondence dated June 6, 1998 from Jack Harper to [Taxpayers' attorney] summarizing the information requested by the Department relative to the facts and circumstances of the protested issues not received as of June 6, 1998.

D-4(e) Correspondence dated May 29, 1998 from [Taxpayers' attorney] to Jack Harper advising Department of status of requested documents pertinent to facts and circumstances of protested issues.

D-4(f) Correspondence dated June 5, 1998 from [Taxpayers' attorney] to Donna Powell forwarding information requested pursuant to a review of federal consolidated 1120 tax returns in office of [Taxpayers' attorney].

D-5 Graphic presentation of the chronology of transactions between the [Taxpayers' Parent Company and the Parent Company's] subsidiaries concerning the creation of affiliated corporations, and the transfer, sublicensing, or assignment of intangible assets.

D-6(a) Initial Board of Directors' minutes of [Taxpayer, Subsidiary Trademark Company One] dated January 29, 1981.

D-6(b) Certificate of Incorporation from Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company One] dated December 19, 1980.

D-6(c) Corporate Bylaws for [Taxpayer, Subsidiary Trademark Company One].

D-7(a) Assignment of trade/service marks from [the Taxpayers' Parent Company] to [Taxpayer, Subsidiary Trademark Company One] dated January 28, 1981.

D-7(b) Legal name change document filed with the State of Delaware certifying [a name change for Taxpayer, Subsidiary Trademark Company One] dated April 25, 1994.

D-8(a) U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company One].

D-8(b) Portfolio printouts of [Taxpayer, Subsidiary Trademark Company One's trademarks] in foreign jurisdictions.

D-9(a)	Related Company Agreement made and entered into February 1, 1981 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer's Parent Company].
D-9(b)	Amendment #1 to Related Company Agreement made and entered into June 29, 1981 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer's Parent Company].
D-9(c)	Amendment #3 to Related Company Agreement made and entered into October 22, 1987 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer's Parent Company].
D-9(d)	Amendment #4 to Related Company Agreement made and entered into May 1, 1989 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer's Parent Company].
D-9(e)	Amendment #5 to Related Company Agreement made and entered into September 15, 1992 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer's Parent Company].
D-10	Valuation study of [tradename] prepared by [a consulting firm] dated 1/29/94.
D-11(a)	License Agreement made and entered into September 10, 1987 by and between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer, Subsidiary Trademark Company Four].
D-11(b)	Sublease agreement made and entered into November 30, 1993 by and between [a Delaware corporate management company] and [Taxpayer, Subsidiary Trademark Company One].
D-11(c)	Board of Directors' minutes dated March 17, 1987 for [Taxpayer, Subsidiary Trademark Company One].
D-12(a)	Board of Directors' minutes dated September 10, 1987 for [Taxpayer, Subsidiary Trademark Company One].
D-12(b)	Board of Directors' minutes dated June 3, 1987 for [Taxpayer, Subsidiary Trademark Company One].
D-13	Board of Directors' minutes dated December 1,1987 for [Taxpayer, Subsidiary Trademark Company One].
D-14	Board of Directors' minutes dated March 1, 1988 for [Taxpayer, Subsidiary Trademark Company One].

D-15 Board of Directors' minutes dated June 15, 1988 for [Taxpayer, Subsidiary Trademark Company One].

D-16 Board of Directors' minutes dated September 20, 1988 for [Taxpayer, Subsidiary Trademark Company One].

D-17 Trade Property License Agreement between [Taxpayer, Subsidiary Trademark Company One] and [an unrelated third party] dated 8/24/88.

D-18(a) Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company One].

D-18(b) Board of Directors' minutes dated December 6, 1988 for [Taxpayer, Subsidiary Trademark Company One].

D-18(c) Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company One].

D-18(d) Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company One].

D-19 Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company One].

D-20(a) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company One].

D-20(b) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company One].

D-20(c) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company One].

D-20(d) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company One].

D-20(e) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company One].

D-20(f) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company One].

D-21(a) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company One].

D-21(b) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company One].

D-22 Related Company Agreement made and entered between [Taxpayer, Subsidiary Trademark Company Four] and [Taxpayer's Parent Company].

D-23(a) License Agreement made and entered into March 31, 1989 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer, Subsidiary Trademark Company Four].

D-23(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Four] dated September 9, 1987.

D-23(c) State of Delaware 1992 annual franchise tax report for [Taxpayer, Subsidiary Trademark Company Four] dated February 12, 1993.

D-23(d) State of Delaware 1993 annual franchise tax report for [Taxpayer, Subsidiary Trademark Company Four] dated February,1994.

D-23(e) State of Delaware 1994 annual franchise tax report for [Taxpayer, Subsidiary Trademark Company Four] dated February 1, 1995.

D-23(f) Corporate Bylaws for [Taxpayer, Subsidiary Trademark Company Four].

D-23(g) Sublease Agreement dated November 30, 1993 between [a Delaware corporate management company] and [Taxpayer, Subsidiary Trademark Company Four]

D-23(h) Initial Board of Directors' minutes dated September 10, 1987 for [Taxpayer, Subsidiary Trademark Company Four]

D-24 Valuation study of [trade/service mark] prepared by [an accounting firm] dated January 28, 1995.

D-25(a) U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company Four]

D-25(b) Portfolio printouts of [Taxpayer, Subsidiary Trademark Company Four's] trademarks registered in foreign jurisdictions.

D-26 Board of Directors' minutes dated December 1, 1987 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(a) Board of Directors' minutes dated March 1, 1988 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(b) Board of Directors' minutes dated June 15, 1988 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(c) Board of Directors' minutes dated September 20, 1988 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(d) Board of Directors' minutes dated December 6, 1988 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(e) Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(f) Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(g) Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Four].

D-27(h) Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Four].

D-28(a) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Four].

D-28(b) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Four].

D-28(c) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Four].

D-28(d) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Four].

D-29(a) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Four].

D-29(b) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Four].

D-29(c) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Four].

D-29(d) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Four].

D-30(a) Initial Board minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Seven].

D-30(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Seven] dated August 1, 1991.

D-30(c) Bylaws of [Taxpayer, Subsidiary Trademark Company Seven].

D-31(a) License Agreement made and entered into December 31, 1991 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayer, Subsidiary Trademark Company Seven].

D-31(b) Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Seven].

D-32 Related Company Agreement between [Taxpayer, Subsidiary Trademark Company Seven] and [Related Retail Company Seven] dated September 9, 1991.

D-33 Copy of "Valuation of the [Tradename] for [Taxpayer, Subsidiary Trademark Company Seven]" prepared by [a consulting firm] dated July 1, 1992.

D-34(a) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Seven].

D-34(b) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Seven].

D-34(c) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Seven].

D-34(d) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Seven].

D-34(e) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Seven].

D-34(f) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Seven].

D-35(a) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Seven].

D-35(b) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Seven].

D-35(c) Income Statement Analysis for [Taxpayer, Subsidiary Trademark Company Seven] for tax years ended 1992 through 1994.

D-35(d) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Seven] for tax year ended 1992.

D-35(e) [Taxpayer, Subsidiary Trademark Company Seven] for tax year ended 1993.

D-35(f) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Seven] for tax year ended 1994.

D-36 Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Seven].

D-37(a) U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company Eight].

D-37(b) Portfolio printout of [Taxpayer, Subsidiary Trademark Company Eight's] trademark registered in foreign jurisdictions.

D-37(c) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Eight] dated August 1, 1991.

D-37(d) Corporate Bylaws of [Taxpayer, Subsidiary Trademark Company Eight].

D-38 Initial minutes of Board of Directors' meeting of [Taxpayer, Subsidiary Trademark Company Eight] dated December 11, 1991.

D-39(a) Related Company Agreement made and entered into December 11, 1991 by and between [Taxpayer, Subsidiary Trademark Company Eight] and [Related Retail Company Four].

D-39(b) Related Company Agreement made and entered into December 11, 1991 between [Taxpayer, Subsidiary Trademark Company Eight] and [Related Retail Company Eight].

D-40 Valuation study of the [tradename] prepared by [a consulting firm].

D-41(a) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Eight].

D-41(b) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Eight].

D-41(c) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Eight].

D-41(d) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Eight].

D-41(e) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Eight].

D-41(f) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Eight].

D-42(a) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Eight].

D-42(b) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Eight].

D-42(c) Income Statement Analysis of [Taxpayer, Subsidiary Trademark Company Eight] for tax years ended 1992 through 1994.

D-42(d) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight] for tax year ended 1992.

D-42(e) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight] for tax year ended 1993.

D-42(f) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight] for tax year ended 1994.

D-43(a) Initial Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Three].

D-43(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Three] dated August 1, 1991.

D-43(c) Bylaws of [Taxpayer, Subsidiary Trademark Company Three].

D-44(a) Assignment of [Trademark] from [Taxpayers' Parent Company] to [Taxpayer, Subsidiary Trademark Company Three] dated September 9, 1991.

D-44(b) Related Company Agreement made and entered into as of January 1, 1991 by and between [Taxpayer, Subsidiary Trademark Company Three] and [Related Retail Company Three].

D-45(a) U.S. Patent registration printout of record of [tradename] owned by [Taxpayer, Subsidiary Trademark Company Three].

D-45(b) Portfolio printout of [Taxpayer, Subsidiary Trademark Company Three] tradenames registered in foreign jurisdictions.

D-46 Related Company Agreement made and entered into January 1, 1992 by and between [Taxpayer, Subsidiary Trademark Company Three] and [Related Retail Company Three].

D-47 Valuation study of the [tradename] prepared by [a consulting firm].

D-48(a) Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(b) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(c) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(d) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(e) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(f) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Three].

D-48(g) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Three].

D-49(a) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Three].

D-49(b) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Three].

D-49(c) Income Statement Analysis of [Taxpayer, Subsidiary Trademark Company Three] for tax years ended 1992 through 1994.

D-49(d) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three] for tax year ended 1992.

D-49(e) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three] for tax year ended 1993.

D-49(f) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three] for tax year ended 1994.

D-50(a) Assignment of [trademark] from [Related Retail Company Nine] to [Taxpayer, Subsidiary Trademark Company Nine], Inc. dated January 26, 1987.

D-50(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Nine], Inc. dated November 2, 1983.

D-50(c) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Nine] dated December 1, 1988.

D-50(d) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Related Retail Company Nine] dated January 9, 1989.

D-51(a) Related Company Agreement made and entered into January 1, 1987 between [Taxpayer, Subsidiary Trademark Company Nine] and [Related Retail Company Nine].

D-51(b) Related Company Agreement made and entered into January 1, 1989 between [Taxpayer, Subsidiary Trademark Company Nine] and [Related Retail Company Nine].

D-52(a) License Agreement made and entered into January 1, 1989 between [Taxpayer, Subsidiary Trademark Company Nine], Inc. and [Taxpayer, Subsidiary Trademark Company Nine].

D-52(b) Board of Directors' minutes dated March 17, 1987 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(c) Board of Directors' minutes dated June 3, 1987 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(d) Board of Directors' minutes dated September 10, 1987 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(e) Board of Directors' minutes dated December 1, 1987 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(f) Board of Directors' minutes dated March 1, 1988 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(g) Board of Directors' minutes dated June 15, 1988 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(h) Board of Directors' minutes dated September 20, 1988 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(i) Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(j) Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(k) Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(l) Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(m) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(n) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(o) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(p) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(q) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(r) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(s) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(t) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Nine].

D-52(u) Income Statement Analysis of [Taxpayer, Subsidiary Trademark Company Nine] for tax years ended 1992 through 1994.

D-52(v) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for tax year ended 1992.

D-52(w) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for tax year ended 1993.

D-52(x) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for tax year ended 1994.

D-52(y) "Subscription to Shares" of [Taxpayer, Subsidiary Trademark Company Nine] dated December 1, 1988.

D-52(z) Sublease Agreement made and entered into November 30, 1993 by and between [a Delaware corporate management company] and [Taxpayer, Subsidiary Trademark Company Nine].

D-53 Trade Property License Agreement between [Taxpayer, Subsidiary Trademark Company Nine] and [an unrelated third party] dated August 24, 1988.

D-54 Valuation Study of [tradename] as compiled by [an accounting firm] dated May 24, 1995.

D-55(a) U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company Five].

D-55(b) Portfolio printouts of [Taxpayer, Subsidiary Trademark Company Five's] trademarks in foreign jurisdictions.

D-56(a) Assignment of [trade/service marks] from [Related Retail Company Five] to [Taxpayer, Subsidiary Trademark Company Five].

D-56(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Five] dated December 15,1982.

D-56(c) Bylaws of [Taxpayer, Subsidiary Trademark Company Five].

D-56(d) Sublease Agreement made and entered into November 30, 1993 between [a Delaware corporate management company] and [Taxpayer, Subsidiary Trademark Company Five].

D-57(a) Related Company Agreement made and entered into February 2, 1986 between [Taxpayer, Subsidiary Trademark Company Five] and [Related Retail Company Five].

D-57(b) Board of Directors' minutes dated March 17, 1987 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(c) Board of Directors' minutes dated September 10, 1987 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(d) Board of Directors' minutes dated June 3, 1987 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(e) Board of Directors' minutes dated December 1, 1987 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(f) Board of Directors' minutes dated March 1, 1988 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(g) Board of Directors' minutes dated June 15, 1998 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(h) Board of Director's minutes dated September 20, 1988 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(i) Board of Directors' minutes dated December 6, 1988 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(j) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(k) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(l) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(m) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(n) Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company Five].

D-57(o) Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(a) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(b) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(c) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(d) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(e) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(f) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(g) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Five].

D-58(h) Board of Directors' minutes dated December 1, 1993 for [Taxpayer, Subsidiary Trademark Company Five].

D-59 Valuation study of [trade/service mark] as compiled by [an accounting firm] dated January 28, 1995.

D-60(a) Assignment of [trade/service mark] from [a corporation] to [Related Retail Company Six] dated June 6, 1985.

D-60(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Six] dated May 2, 1985.

D-60(c)	Corporate Bylaws for [Taxpayer, Subsidiary Trademark Company Six].
D-60(d)	Sublease Agreement made and entered into January 9, 1989 between [a Delaware corporate management company] and [Taxpayer, Subsidiary Trademark Company Six].
D-61(a)	U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company Six].
D-61(b)	Portfolio printouts of [Taxpayer, Subsidiary Trademark Company Six's] [trademarks] in foreign jurisdictions.
D-62(a)	Related Company Agreement made and entered into June 6, 1985 between [Taxpayer, Subsidiary Trademark Company Six] and [Related Retail Company Six].
D-62(b)	Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(c)	Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(d)	Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(e)	Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(f)	Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(g)	Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(h)	Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Six].
D-62(i)	Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Six].
D-63(a)	Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Six].
D-63(b)	Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Six].

D-63(c) Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Six].

D-63(d) Board of Directors' minutes dated December 1, 1993 [Taxpayer, Subsidiary Trademark Company Six].

D-63(e) Income Statement Analysis of [Taxpayer, Subsidiary Trademark Company Six] for tax years ended 1992-1994.

D-63(f) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six] for tax year ended 1992.

D-63(g) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six] for tax year ended 1993.

D-63(h) Balance Sheet and Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six] for tax year ended 1994.

D-64 Valuation study of [trade/service marks] as compiled by [an accounting firm] dated October 31, 1989.

D-65(a) U.S. Patent Registration printout of record of [trade/service mark] owned by [Taxpayer, Subsidiary Trademark Company Two].

D-65(b) Portfolio printouts of [Taxpayer, Subsidiary Trademark Company Two's] [trademark] in foreign jurisdictions.

D-66(a) Related Company Agreement made and entered into February 2, 1988 between [Taxpayer, Subsidiary Trademark Company Two] and [Related Retail Company Two].

D-66(b) Certificate of Incorporation from State of Delaware Secretary of State's Office for [Taxpayer, Subsidiary Trademark Company Two] dated February 2, 1988.

D-66(c) Corporate Bylaws for [Taxpayer, Subsidiary Trademark Company Two].

D-66(d) Board of Directors' minutes dated March 12, 1991 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(e) Board of Directors' minutes dated June 4, 1991 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(f) Board of Directors' minutes dated September 9, 1991 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(g) Board of Directors' minutes dated December 11, 1991 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(h) Board of Directors' minutes dated March 10, 1992 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(i) Board of Directors' minutes dated June 9, 1992 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(j) Board of Directors' minutes dated September 10, 1992 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(k) Board of Directors' minutes dated December 9, 1992 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(l) Board of Directors' minutes dated March 9, 1993 for [Taxpayer, Subsidiary Trademark Company Two].

D-66(m) Board of Directors' minutes dated June 8, 1993 for [Taxpayer, Subsidiary Trademark Company Two].

D-67 Board of Directors' minutes dated September 21, 1993 for [Taxpayer, Subsidiary Trademark Company Two].

D-68 Graphic of the [Taxpayers' Parent Company] and its subsidiaries displaying the licensing relationship between the retail operation and trademark entity.

D-69(a) Letter outlining services provided to Delaware Holding Companies from [a nexus service provider] dated January 5, 1987.

D-69(b) Printout of corporations listing [a specific Delaware address] as their principal physical address.

D-69(c) Resolution authorizing [a bank] to act as a depository of funds for [Taxpayer, Subsidiary Trademark Company Seven] dated September 9, 1991.

D-69(d) Invoice from [a Delaware corporate management company] to [Taxpayer, Subsidiary Trademark Company One] dated January 19, 1993 for accounting services.

D-70 Summary of Trademark Companies' Royalty and Interest Income for tax years ended 1992 through 1994.

D-71	Graphic displaying “Circular Flow of Transactions” between retail companies and their related trademark companies.
D-72	Analysis of gross income and expenses of trademark companies and their related retail companies.
D-73(a)	“Analysis of accrued royalties” for [Taxpayer, Subsidiary Trademark Company Four] for taxable years ended 1992, 1993, and 1994.
D-73(b)	Balance Sheet for [Taxpayer, Subsidiary Trademark Company Four] for taxable years ended 1992, 1993, and 1994.
D-73(c)	[Bank] Statement of Account for [Taxpayer, Subsidiary Trademark Company Four] for taxable years ended January 31, 1992, January 29, 1993, and January 31, 1994.
D-73(d)	[Bank] Statement for [Taxpayer, Subsidiary Trademark Company Four] dated April 3, 1992.
D-73(e)	Note between [Related Retail Company Four] and [Taxpayer, Subsidiary Trademark Company Four] dated September 20, 1992.
D-73(f)	“Analysis of accrued royalties” for [Taxpayer, Subsidiary Trademark Company One] for taxable years ended 1992, 1993, and 1994.
D-73(g)(1)	Balance Sheets for [Taxpayer, Subsidiary Trademark Company One] for taxable year ended 1992.
D-73(g)(2)	Balance Sheets for [Taxpayer, Subsidiary Trademark Company One] for taxable year ended 1994.
D-73(h)(1)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company One] for taxable year ended 1992.
D-73(h)(2)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company One] for taxable year ended 1993.
D-73(h)(3)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company One] for taxable year ended 1994.
D-73(i)(1)	[Bank] Statements for [Taxpayer, Subsidiary Trademark Company One] dated April 3, 1992.
D-73(i)(2)	[Bank] Statements for [Taxpayer, Subsidiary Trademark Company One] dated January 29, 1993.

D-73(j)	Note between [Taxpayers' Parent Company, which is also Related Retail Company One] and [Taxpayer, Subsidiary Trademark Company One] dated September 20, 1992.
D-73(k)	"Analysis of accrued royalties" for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended 1992, 1993, and 1994.
D-73(l)(1)	Balance Sheets for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended February 1, 1992.
D-73(l)(2)	Balance Sheets for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 30, 1993.
D-73(l)(3)	Balance Sheets for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 29, 1994.
D-73(m)(1)	Statements of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended February 1, 1992.
D-73(m)(2)	Statements of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 30,1993.
D-73(m)(3)	Statements of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 29, 1994.
D-73(n)(1)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 31, 1992.
D-73(n)(2)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 29, 1993.
D-73(n)(3)	[Trust] Statements of Account for [Taxpayer, Subsidiary Trademark Company Nine] for taxable year ended January 28, 1994.
D-73(o)(1)	[Bank] Statements for [Taxpayer, Subsidiary Trademark Company Nine] dated April 3, 1992.
D-73(o)(2)	[Bank] Statements for [Taxpayer, Subsidiary Trademark Company Nine] dated January 28, 1994.
D-73(p)(1)	Notes between [Related Retail Company Nine] and [Taxpayer, Subsidiary Trademark Company Nine] dated September 20, 1992.
D-73(p)(2)	Notes between [Related Retail Company Nine] and [Taxpayer, Subsidiary Trademark Company Nine] dated November 9, 1992.

D-74(a) Note between [Related Retail Company Four] and [Taxpayer, Subsidiary Trademark Company Four] dated November 9, 1992.

D-74(b) Note between [Related Retail Company Nine] and [Taxpayer, Subsidiary Trademark Company Nine] dated February 7, 1992.

D-74(c) Note between [Related Retail Company Two] and [Taxpayer, Subsidiary Trademark Company Two] dated November 9, 1992.

D-74(d) Note between [Related Retail Company Nine] and [Taxpayer, Subsidiary Trademark Company Nine] dated August 10, 1992.

D-74(e) Note between [Related Retail Company Nine] and [Taxpayer, Subsidiary Trademark Company Nine] dated May 12, 1992.

D-74(f) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated March 20, 1989.

D-74(g) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1990.

D-74(h) Note between [Related Retail Company Two] and [Taxpayer, Subsidiary Trademark Company Two] dated September 20, 1992.

D-74(i) Note between [Related Retail Company Two] and [Taxpayer, Subsidiary Trademark Company Two] dated May 12, 1992.

D-74(j) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1992.

D-74(k) Note between [Related Retail Company Six] and [Taxpayer, Subsidiary Trademark Company Six] dated September 20, 1992.

D-74(l) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1989.

D-74(m) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1991.

D-74(n) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1992.

D-74(o) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated March 20, 1993.

D-74(p) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1992.

D-74(q) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated March 20, 1993.

D-74(r) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated September 20, 1993.

D-74(s) Note between [Related Retail Company Five] and [Taxpayer, Subsidiary Trademark Company Five] dated March 20, 1991.

D-75(a) Related Company Agreement Amendment # 3 made and entered into October 22, 1987 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(b) Related Company Agreement made and entered into February 1, 1981 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(c) Related Company Agreement Amendment # 1 made and entered into June 29, 1981 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(d) Related Company Agreement Amendment # 2 made and entered into September 10, 1987 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(e) Related Company Agreement Amendment #4 made and entered into May 1, 1989 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(f) Related Company Agreement Amendment #5 made and entered into September 15, 1992 between [Taxpayer, Subsidiary Trademark Company One] and [Taxpayers' Parent Company, which is also Related Retail Company One].

D-75(g) Related Company Agreement Amendment #2 made and entered into May 1, 1989 between [Taxpayer, Subsidiary Trademark Company Five] and [Related Retail Company Five].

D-75(h) Related Company Agreement made and entered into February 2, 1986 between [Taxpayer, Subsidiary Trademark Company Five] and [Related Retail Company Five].

D-75(i) Related Company Agreement Amendment #1 made and entered into October 22, 1987 between [Taxpayer, Subsidiary Trademark Company Five] and [Related Retail Company Five].

D-75(j) Related Company Agreement Amendment #1 made and entered into May 1, 1989 between [Taxpayer, Subsidiary Trademark Company Nine] and [Related Retail Company Nine].

D-75(k) Related Company Agreement Amendment # 2 made and entered into May 1, 1989 between [Taxpayer, Subsidiary Trademark Company Six] and [Related Retail Company Six].

D-76(a) Securities and Exchange Commission 10-K Reports for the [Taxpayers' Parent Company] and subsidiaries dated February 2, 1991.

D-76(b) Securities and Exchange Commission 10-K Reports for the [Taxpayers' Parent Company] and subsidiaries dated February 2, 1992.

D-76(c) Securities and Exchange Commission 10-K Reports for the [Taxpayers' Parent Company] and subsidiaries dated January 30, 1993.

D-76(d) Securities and Exchange Commission 10-K Reports for the [Taxpayers' Parent Company] and subsidiaries dated January 29, 1994.

D-77 North Carolina Administrative Rule 17 NCAC 5C.0102, "Doing Business Defined".

D-78 Omitted.

D-79 North Carolina Department of Revenue Redacted Final Decision Docket Number 90-33.

D-80 Excerpt from "State Taxation -1997/1998 Cumulative Supplement" by Jerome R. Hellerstein and Walter Hellerstein.

D-81(a) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company One] dated December 31, 1992.

D-81(b) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company One] dated April 2, 1993.

D-81(c) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company Four] dated November 30, 1992.

D-81(d) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company Four] dated April 2, 1993.

D-81(e) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company Nine] dated December 31, 1992.

D-81(f) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company Nine] dated April 2, 1993.

D-81(g) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company One] dated December 31, 1992.

D-81(h) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company One] dated April 2, 1993.

D-81(i) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company One] dated September 30, 1992.

D-81(j) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company One] dated February 26, 1993.

D-81(k) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company Four] dated November 30, 1992.

D-81(l) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company Four] dated April 2, 1993.

D-81(m) [Legal fee billing statement] for [Taxpayer, Subsidiary Trademark Company Four] dated December 31, 1992.

D-81(n) [Bank] Statement for [Taxpayer, Subsidiary Trademark Company Four] dated May 28, 1993.

D-82(a)(1) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Two].

D-82(a)(2) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Three].

D-82(a)(3) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Four].

D-82(a)(4) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Five].

D-82(a)(5) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Six].

D-82(a)(6) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company One].

D-82(a)(7) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(a)(8) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(a)(9) January 1992 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Nine].

D-82(b)(1) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Two].

D-82(b)(2) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Three].

D-82(b)(3) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Four].

D-82(b)(4) January 1993 Balance Sheet for, [Taxpayer, Subsidiary Trademark Company Five].

D-82(b)(5) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Six].

D-82(b)(6) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company One].

D-82(b)(7) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(b)(8) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(b)(9) January 1993 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Nine].

D-82(c)(1) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Two].

D-82(c)(2) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Three].

D-82(c)(3) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Four].

D-82(c)(4) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Five].

D-82(c)(5) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Six].

D-82(c)(6) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company One].

D-82(c)(7) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(c)(8) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(c)(9) January 1994 Balance Sheet for [Taxpayer, Subsidiary Trademark Company Nine].

D-82(d)(1) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Two].

D-82(d)(2) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three].

D-82(d)(3) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Four].

D-82(d)(4) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Five].

D-82(d)(5) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six].

D-82(d)(6) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company One].

D-82(d)(7) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(d)(8) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(d)(9) January 1992 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine].

D-82(e)(1) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Two].

D-82(e)(2) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three].

D-82(e)(3) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Four].

D-82(e)(4) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Five].

D-82(e)(5) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six].

D-82(e)(6) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company One].

D-82(e)(7) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(e)(8) January 1993 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(e)(9) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine].

D-82(f)(1) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Two].

D-82(f)(2) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Three].

D-82(f)(3) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Four].

D-82(f)(4) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Five].

D-82(f)(5) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Six].

D-82(f)(6) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company One].

D-82(f)(7) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Seven].

D-82(f)(8) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Eight].

D-82(f)(9) January 1994 Statement of Income and Retained Earnings for [Taxpayer, Subsidiary Trademark Company Nine].

D-83(a)(1) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Two].

D-83(a)(2) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Three].

D-83(a)(3) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Four].

D-83(a)(4) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Five].

D-83(a)(5) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Six].

D-83(a)(6) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company One].

D-83(a)(7) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Seven].

D-83(a)(8) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Eight].

D-83(a)(9) January 30, 1992 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Nine].

D-83(a)(10) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Two].

D-83(a)(11) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Three].

D-83(a)(12) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Four].

D-83(a)(13) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Five].

D-83(a)(14) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Six].

D-83(a)(15) January 30, 1992 pro-forma federal tax returns for [Taxpayers' Parent Company, which is also Related Retail Company One].

D-83(a)(16) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Seven].

D-83(a)(17) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Eight].

D-83(a)(18) January 30, 1992 pro-forma federal tax returns for [Related Retail Company Nine].

D-83(a)(19) Federal Corporation Income Tax Return (Consolidated Federal 1120) for [Taxpayers' Parent Company and Subsidiaries] for tax year ended 1992.

D-83(b)(1) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Two].

D-83(b)(2) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Three].

D-83(b)(3) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Four].

D-83(b)(4) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Five].

D-83(b)(5) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Six].

D-83(b)(6) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company One]

D-83(b)(7) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Seven].

D-83(b)(8) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Eight].

D-83(b)(9) January 30, 1993 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Nine].

D-83(b)(10) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Two].

D-83(b)(11) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Three].

D-83(b)(12) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Four].

D-83(b)(13) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Five].

D-83(b)(14) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Six].

D-83(b)(15) January 30, 1993 pro-forma federal tax returns for [Taxpayers' Parent Company, which is also Related Retail Company One].

D-83(b)(16) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Seven].

D-83(b)(17) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Eight].

D-83(b)(18) January 30, 1993 pro-forma federal tax returns for [Related Retail Company Nine].

D-83(b)(19) Federal Corporation Income Tax Return (Consolidated Federal 1120) for [Taxpayers' Parent Company and Subsidiaries] for tax year ended 1993.

D-83(c)(1) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Two].

D-83(c)(2) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Three].

D-83(c)(3) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Four].

D-83(c)(4) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Five].

D-83(c)(5) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Six].

D-83(c)(6) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company One].

D-83(c)(7) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Seven].

D-83(c)(8) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Eight].

D-83(c)(9) January 30, 1994 pro-forma federal tax returns for [Taxpayer, Subsidiary Trademark Company Nine].

D-83(c)(10) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Two].

D-83(c)(11) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Three].

D-83(c)(12) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Four].

D-83(c)(13) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Five].

D-83(c)(14) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Six].

D-83(c)(15) January 30, 1994 pro-forma federal tax returns for [Taxpayers' Parent Company, which is also Related Retail Company One].

D-83(c)(16) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Seven].

D-83(c)(17) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Eight].

D-83(c)(18) January 30, 1994 pro-forma federal tax returns for [Related Retail Company Nine].

D-83(c)(19) Federal Corporation Income Tax Return (Consolidated Federal 1120) for [Taxpayers' Parent Company and Subsidiaries] for tax year ended 1994.

D-84(a) 1991 Annual Report for [Taxpayers' Parent Company].

D-84(b) 1992 Annual Report for [Taxpayers' Parent Company].

D-84(c) 1993 Annual Report for [Taxpayers' Parent Company].

D-85 Transcript of Administrative Tax Hearing held June 9, 1998 through June 12, 1998 regarding the proposed assessments against: [Taxpayers].

D-86 Department's "Exhibit List" dated August 31, 1998.

D-87 Department's Initial Post-Hearing Brief dated March 1, 1999.

D-88 Department's Post-Hearing Response Brief dated May 3, 1999.

D-89 Departmental responses to Hearing Officer questions concerning Administrative Tax Hearing of [Taxpayers] dated February 29, 2000.

Submitted by the Taxpayers:

TP-1 Booklet "Why Corporations Choose Delaware" by [an author].

TP-2 "Portfolio Print-Outs" for [Taxpayers, Subsidiary Trademark Companies One, Four, and Six] dated May 18, 1998.

TP-3 Copies of various patent infringement litigation concerning [Taxpayers, Subsidiary Trademark Companies One, Two, Four, and Five].

TP-4 Report entitled "North Carolina Corporate Income Tax Apportionment of Business Income" prepared by [an author] dated June 5, 1998.

TP-5 Report entitled "Nexus and State Corporate Income Taxation" prepared by [a professor] dated June 1998.

TP-6 Report entitled "Economic Analysis of North Carolina Administrative Rule .0102" prepared by [an author].

TP-7	Report entitled “Testing a Related-Party Royalty for Adherence to the Arm’s-Length Standard” prepared by [an author] dated June 1998.
TP-8	Report entitled “Royalty Rate Study – Licensing in the Consumer Goods Industry” prepared by [an author] dated June 1998.
TP-9	Report entitled “Expert Opinion of [Professor].”
TP-10	Excerpt from June 8, 1998 Tax Analysts, State Tax Today.
TP-11	Letter from M. Larry Stanfield, CPA, of the North Carolina Department of Revenue Interstate Audit Division to [representative for Taxpayer, Subsidiary Trademark Company Two] dated October 23, 1995.
TP-12	Letter from [Taxpayers’ Attorney] to Kay Miller Hobart, dated March 26, 1998.
TP-13	Letter from [Taxpayers’ Attorney] to Jack L. Harper dated June 4, 1998.
TP-14	Letter from [Taxpayers’ Attorney] to Hearing Officer Michael A. Hannah dated October 30, 1998.
TP-15	Letter from Hearing Officer Michael A. Hannah to [Taxpayers’ Attorney] dated December 16, 1998.
TP-16	Letter from [Taxpayers’ attorney] to Jack L. Harper dated December 30, 1998.
TP-17	Letter from [Taxpayers’ attorney] to Hearing Officer Michael A. Hannah dated February 8, 1999.
TP-18	Chart regarding the physical presence and activities of Petitioners by location.
TP-19	Response by [Professor] to questions of the North Carolina Department of Revenue dated December 23, 1998.
TP-20	Petitioners’ Initial Post-Hearing Brief dated March 1, 1999.
TP-21	Petitioners’ Post-Hearing Answer Brief dated April 30, 1999.
TP-22	Petitioners’ Sur-reply Brief dated June 28, 1999.
TP-23	Petitioners’ responses to the[Hearing] Questions dated February 29, 2000.

TP-24 Letter to Mr. Michael A. Hannah from [Taxpayers' attorney] dated April 12, 2000.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. The Taxpayers are nine non-domiciliary corporations headquartered in Delaware.

2. The Taxpayers are wholly-owned subsidiaries of [their Parent Company].

3. [The Taxpayers' Parent Company] is primarily engaged in the nationwide retail sale of men's, women's, and children's clothing and accessories.

4. [The Taxpayers' Parent Company's] principal place of business and commercial domicile is located [outside North Carolina].

5. [The Taxpayers' Parent Company] started in business in 1963 and has expanded to over 5,000 stores nationwide and 12 separate retail operating subsidiaries.

6. [The Taxpayers' Parent Company] and its retail operating subsidiaries ("related retail companies") own and operate all of their stores; none are franchised.

7. The Taxpayers own and license trademarks, tradenames, and service marks ("marks") and the goodwill associated with these marks to [their Parent Company] and its related retail companies, nine of which are located in North Carolina.

8. The nine related retail companies operating in North Carolina are: [Related Retail Companies One through Nine].

9. The nine related retail companies operating in North Carolina have over 130 retail locations in North Carolina; these companies extensively use the Taxpayers' marks at these locations.

10. The marks owned by the Taxpayers were all previously owned by either [Taxpayers' Parent Company] or one of the [Parent Company's] related retail companies.

11. The Taxpayers license their marks to the nine related retail companies operating in North Carolina as follows:

[Taxpayer	Related Retail Company
Taxpayer, Subsidiary Trademark Company One	Related Retail Company One
Taxpayer, Subsidiary Trademark Company Two	Related Retail Company Two
Taxpayer, Subsidiary Trademark Company Three	Related Retail Company Three
Taxpayer, Subsidiary Trademark Company Four	Related Retail Company Four
Taxpayer, Subsidiary Trademark Company Five	Related Retail Company Five
Taxpayer, Subsidiary Trademark Company Six	Related Retail Company Six
Taxpayer, Subsidiary Trademark Company Seven	Related Retail Company Seven
Taxpayer, Subsidiary Trademark Company Eight	Related Retail Company Eight
Taxpayer, Subsidiary Trademark Company Nine	Related Retail Company Nine]

12. The structure of the [Taxpayers' Parent Company], the Taxpayers, and the related retail companies is illustrated on the following chart:

[Parent Company, which is also Related Retail Company One]

[Taxpayer, Subsidiary Trademark Company One]
Owns [various marks and licenses them to Taxpayers, Subsidiary Trademark Companies One, Four, and Seven].

[Taxpayer, Subsidiary Trademark Company Five]
Owns [a mark] and licenses it to [Related Retail Company Five].

[Taxpayer, Subsidiary Trademark Company Six]
Owns [a mark] and licenses it to [Related Retail Company Six].

[Taxpayer, Subsidiary Trademark Company Nine]
Owns [a mark] and licenses it to [Related Retail Company Nine].

[Taxpayer, Subsidiary Trademark Company Two]
Owns [a mark] and licenses it to [Related Retail Company Two].

[Taxpayer, Subsidiary Trademark Company Three]
Owns [a mark] and licenses it to [Related Retail Company Three].

[Taxpayer, Subsidiary Trademark Company Seven]
Is licensed by [Taxpayer, Subsidiary Trademark Company Six] to use[a mark]; in turn, licenses the mark to [Related Retail Company Seven].

[Taxpayer, Subsidiary Trademark Company Four]
Is licensed by [Taxpayer, Subsidiary Trademark Company Six] to use [a mark]; in turn, licenses the mark to [Related Retail Company Four].

[Related Retail Company Five]
Related retail company acquired by [Parent Company].

[Related Retail Company Six]
Related retail company acquired by [Parent Company].

[Related Retail Company Nine]
Related retail company acquired by [Parent Company].

[Related Retail Company Two]
Related retail company acquired by [Parent Company].

[Related Retail Company Three]
Related retail company and former division of [Parent Company].

[Related Retail Company Seven]
Related retail company and former division of [Parent Company].

[Related Retail Company Four]
Related retail company and former division of [Parent Company].

[Taxpayer, Subsidiary Trademark Company Eight]
Owns [a mark] and licenses it to [Related Retail Company Eight].

[Related Retail Company Eight]
Related retail company and former division of [Parent Company].

13. The Taxpayers purposefully utilize at least 130 retail locations in North Carolina to prominently display their marks, advertise apparel bearing their marks, and avail themselves of the North Carolina marketplace.

14. The Taxpayers' marks are permanently affixed to the 130 retail locations throughout North Carolina.

15. The related retail companies filed North Carolina franchise and income tax returns for the tax years January 1992 through January 1994 pursuant to G.S. 105-130 *et seq.*

16. The related retail companies reduced their North Carolina tax liability by deducting accrued royalty and interest expenses "paid" by journal entries to Taxpayers, thus producing substantial tax savings.

17. The Taxpayers accrued royalty and interest income on their books for tax years 1992 through 1994.

18. The Taxpayers did not file North Carolina franchise or income tax returns for tax years 1992 through 1994.

19. The Taxpayers did not pay any corporate income tax in Delaware or in any other state on their substantial royalty income and interest income deducted by the related retail companies.

Creation of Taxpayers

20. In its early years of operation, the [Taxpayers' Parent Company] developed and cultivated intangible intellectual property including trademarks, tradenames, service marks, and associated goodwill.

21. [Taxpayers' trademark counsel] testified that a trademark as defined under trademark law is "any name, word, symbol or device which one manufacturer or provider of services uses to distinguish his goods or services from like goods or services of another." (T. 6/9/98, p. 232).

22. [The Taxpayers' Parent Company] incurred substantial expenses in the development of its marks. The expenses were deducted from the [its] gross income in the determination of its federal taxable income.

23. The [Parent Company's] North Carolina taxable income was also reduced by the expenses associated with the development of its marks because [its] North Carolina net income was based on its federal taxable income.

24. The value and significance of the [Parent Company's trademark] increased as the number of the [Parent Company's] stores increased.

25. All of the [Parent Company's] marks were registered, monitored, policed, and defended against infringement by [its] own in-house legal counsel prior to the formation of Taxpayers.

26. Officers of the [Parent Company], including [its Executive Vice-President and Chief Financial Officer], concluded that the creation of a separate trademark holding company was the best way to protect the trademark from being "knocked off." (T. 6/9/98, p. 45).

27. The [Parent Company's] Board of Directors authorized the establishment of a separate trademark company to hold the [Parent Company's trademark].

28. On December 19, 1980, Articles of Incorporation were filed with the Delaware Secretary of State incorporating [Taxpayer, Subsidiary Trademark Company One].

29. [Taxpayer, Subsidiary Trademark Company One] held its first Board of Directors' meeting on January 29, 1981.

30. At this meeting, the Board authorized a tax-free exchange of assets for stock between the [Parent Company] and [Taxpayer, Subsidiary Trademark Company One] in accordance with I.R.C. § 351, which is a common method of capitalizing subsidiaries.

31. Also on January 29, 1981, [Taxpayer, Subsidiary Trademark Company One] issued 100 shares of its common stock, par value $1.00 per share, to the [Parent Corporation] for $100. In addition, the [Parent Corporation] made a $10,000 capital contribution to [Taxpayer, Subsidiary Trademark Company One].

32. The [Parent Company] became the sole shareholder of [Taxpayer, Subsidiary Trademark Company One].

33. By written Assignment dated January 28, 1981 [the Parent Company] assigned its marks and associated goodwill to [Taxpayer, Subsidiary Trademark Company One].

34. The [Parent Company] received little or no consideration for the transfer of its marks and goodwill to [Taxpayer, Subsidiary Trademark Company One].

35. The [Parent Company] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company One].

36. Both [Taxpayer, Subsidiary Trademark Company One] and the [Parent Company] filed registration statements with the United States Patent and Trademark Office reporting the change in ownership of the [trademark] together with the goodwill established by the trademark from the [Parent Corporation] to [Taxpayer, Subsidiary Trademark Company One].

37. [Taxpayer, Subsidiary Trademark Company One] did not register the [trademark] with the North Carolina Secretary of State's Office.

38. On January 29, 1981, the same day that the [Parent Company, which is also Related Retail Company One] assigned its marks and related goodwill to [Taxpayer, Subsidiary Trademark Company One], [Taxpayer, Subsidiary Trademark Company One] and the [Parent Company and Related Retail Company One] entered into a licensing agreement whereby [Taxpayer, Subsidiary Trademark Company One] granted the [Parent Company and Related Retail Company One] the right to use its marks in the [Parent Company's and Related Retail Company One's] retail operations.

39. [Taxpayer, Subsidiary Trademark Company One] received, under the terms of the licensing agreement, royalties in the amount of 5% of the [Parent Company's and Related Retail Company One's] retail sales.

40. On January 29, 1981, the same day that the [Parent Company and Related Retail Company One] assigned its marks and related goodwill to [Taxpayer, Subsidiary Trademark Company One], [Taxpayer, Subsidiary Trademark Company One] and the [Parent Company and Related Retail Company One] entered into a loan agreement whereby [Taxpayer, Subsidiary Trademark Company One] agreed to loan the [Parent Company and Related Retail Company One] money on a secured or unsecured basis, in an amount not to exceed $2,000,000. The loan agreement required the [Parent Company and Related Retail Company One] to repay [Taxpayer, Subsidiary Trademark Company One] any outstanding loan balance in 90 days and required the [Parent Company and Related Retail Company One] to accrue and pay interest at the current prime rate.

41. The [Parent Company] acquired several retail establishments specializing in varying areas of apparel and began to operate these companies as wholly-owned subsidiaries. The acquired retail companies were: [Related Retail Companies Two, Five, Six, and Nine].

42. The marks owned by each of the acquired retail companies had name recognition and associated goodwill prior to acquisition of the retail companies by the [Parent Company].

43. The [Parent Company] created separate trademark companies in a manner consistent with the tax-free creation of [Taxpayer, Subsidiary Trademark Company One].

44. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Five], was incorporated in Delaware on December 15, 1982.

45. The retail company, [Related Retail Company Five], assigned its [trademark], together with the goodwill of the business symbolized by the trademark, to [Taxpayer, Subsidiary Trademark Company Five] by a written Assignment recorded with United States Patent and Trademark Office.

46. [Related Retail Company Five] received little or no consideration from [Taxpayer, Subsidiary Trademark Company Five] for its trademarks.

47. [Related Retail Company Five] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company Five].

48. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Six], was incorporated in Delaware on May 2, 1985.

49. The retail company, [Related Retail Company Six], assigned its [trademark] together with the goodwill of the business symbolized by the trademark, to [Taxpayer, Subsidiary Trademark Company Six] by written Assignment recorded with the United States Patent and Trademark Office.

50. [Related Retail Company Six] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company Six].

51. [Related Retail Company Six] received little or no consideration from [Taxpayer, Subsidiary Trademark Company Six] for its trademarks.

52. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Two], was incorporated in Delaware on February 2, 1988.

53. The retail company, [Related Retail Company Two], assigned its [trademark] together with the goodwill of the business symbolized by the trademark, to [Taxpayer, Subsidiary Trademark Company Two] by written Assignment recorded with the United States Patent and Trademark Office.

54. [Related Retail Company Two] received little or no consideration from [Taxpayer, Subsidiary Trademark Company Two] for its trademarks.

55. [Related Retail Company Two] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company Two].

56. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Nine], was incorporated in Delaware on December 1, 1988.

57. The retail company, [Related Retail Company Nine], assigned its [trademark] together with the goodwill of the business symbolized by the trademark, to [Taxpayer, Subsidiary Trademark Company Nine] by written Assignment recorded with the United States Patent and Trademark Office.

58. [Related Retail Company Nine] received little or no consideration from [Taxpayer, Subsidiary Trademark Company Nine] for its trademarks.

59. [Related Retail Company Nine] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company Nine].

60. In addition to acquiring retail companies, the [Parent Company] developed its own retail companies by incorporating various business segments or divisions operated by the [Parent Company] The retail divisions incorporated as wholly-owned subsidiaries of the [Parent Company] were: [Related Retail Companies Three, Four, and Seven].

61. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Four], was incorporated in Delaware on September 9, 1987.

62. On September 10, 1987, [Taxpayer, Subsidiary Trademark Company Four] issued 100 shares of its common stock, par value $1.00 per share, to the trademark holding company, [Taxpayer, Subsidiary Trademark Company One], in exchange for $100. In addition, [Taxpayer, Subsidiary Trademark Company One] made a $20,000 capital contribution to [Taxpayer, Subsidiary Trademark Company Four].

63. Also on September 10, 1987, [Taxpayer, Subsidiary Trademark Company One] granted [Taxpayer, Subsidiary Trademark Company Four] a non-exclusive license to use [two tradenames] and the right to sub-license these tradenames to other companies.

64. [Taxpayer, Subsidiary Trademark Company One] did not charge [Taxpayer, Subsidiary Trademark Company Four] any royalty fee for the use of its [mark].

65. [Taxpayer, Subsidiary Trademark Company One] did not have its trademark valued by a third party for a determination of the trademark's actual worth before licensing the trademark to [Taxpayer, Subsidiary Trademark Company Four].

66. [Taxpayer, Subsidiary Trademark Company Seven], was incorporated in Delaware on August 1, 1991.

67. On December 31, 1991, [Taxpayer, Subsidiary Trademark Company Seven] issued 100 shares of its common stock, par value $1.00 per share, to [Taxpayer, Subsidiary Trademark Company One], in exchange for $100. In addition, [Taxpayer, Subsidiary Trademark Company One] made a $10,000 capital contribution to [Taxpayer, Subsidiary Trademark Company Seven].

68. [Taxpayer, Subsidiary Trademark Company One] became the sole shareholder of [Taxpayer, Subsidiary Trademark Company Seven].

69. On September 9, 1991, [Taxpayer, Subsidiary Trademark Company One] granted to [Taxpayer, Subsidiary Trademark Company Seven] a non-exclusive license to use [a trademark].

70. [Taxpayer, Subsidiary Trademark Company Seven] licensed the [tradename] from [Taxpayer, Subsidiary Trademark Company One], the [Parent Company's] wholly-owned subsidiary that owned the trademark.

71. [Taxpayer, Subsidiary Trademark Company One] did not charge [Taxpayer, Subsidiary Trademark Company Seven] any royalty fee for the use of its [mark].

72. [Taxpayer, Subsidiary Trademark Company One] did not have its trademark valued by a third party for a determination of the trademark's actual worth before licensing the trademark to [Taxpayer, Subsidiary Trademark Company Seven].

73. The trademark holding company, [Taxpayer, Subsidiary Trademark Company Eight], was incorporated in Delaware on August 1, 1991.

74. On December 11, 1991, [Taxpayer, Subsidiary Trademark Company Eight] issued 100 shares of its common stock, par value $1.00 per share, to [Related Retail Company Four] for $100. In addition, [Related Retail Company Four] made a $20,000 capital contribution to [Taxpayer, Subsidiary Trademark Company Eight].

75. [Related Retail Company Four] is the sole shareholder of both [Related Retail Company Eight] and [Taxpayer, Subsidiary Trademark Company Eight].

76. On December 11, 1991, [Related Retail Company Four] assigned [a trademark] together with its associated goodwill to [Taxpayer, Subsidiary Trademark Company Eight].

77. Also on December 11, 1991, [Taxpayer, Subsidiary Trademark Company Eight] licensed [the tradename] to [Related Retail Company Four] under the terms of a Related Company Agreement.

78. [Taxpayer, Subsidiary Trademark Company Eight] did not charge [Related Retail Company Four] any royalty fee for the use of its [mark].

79. [Taxpayer, Subsidiary Trademark Company Eight] did not have its trademark valued by a third party for a determination of the trademark's actual worth before licensing the trademark to [Related Retail Company Four] or [Related Retail Company Eight].

80. The trademark holding company [Taxpayer, Subsidiary Trademark Company Three] was incorporated in Delaware on August 1, 1991.

81. On September 9, 1991, [Taxpayer, Subsidiary Trademark Company Three] issued 100 shares of its common stock, par value $1.00 per share, to the [Parent Company] for $100. In addition, the [Parent Company] made a $10,000 capital contribution to [Taxpayer, Subsidiary Trademark Company Three].

82. Also on September 9, 1991, the [Parent Company] assigned to [Taxpayer, Subsidiary Trademark Company Three] [a trademark] together with its associated goodwill.

83. On January 1, 1991, [Taxpayer, Subsidiary Trademark Company Three] licensed the [tradename] to [Related Retail Company Three] under the terms of a Related Company Agreement.

84. The [Parent Company] did not have its trademark valued by a third party for a determination of the trademark's actual worth before assigning the trademark to [Taxpayer, Subsidiary Trademark Company Three].

85. All corporate formalities required by Delaware laws were observed in the creation of each Taxpayer.

86. Taxpayer and its corresponding related retail companies properly filed registration statements with the United States Patent and Trademark Office indicating the transfer to the Assignee of the right, title, and interest in the trademarks together with the goodwill of the business connected with the use of the marks.

87. The Taxpayers did not register their trademarks or tradenames with the North Carolina Secretary of State, relying instead on the registrations with the United States Patent and Trademark Office.

88. Upon the creation or acquisition of each Taxpayer and the tax-free assignment or grant of a license to use or sublicense the marks, each Taxpayer would license or sublicense the use of the marks back to the respective related retail company pursuant to a related company licensing agreement.

89. Each related company licensing agreement followed the format established by the original [licensing agreement for Taxpayer, Subsidiary Trademark Company One].

90. Each related company licensing agreement entered into between a Taxpayer and the related retail company gave the related retail company a non-exclusive license to use the Taxpayer's trademarks, tradenames, service marks, and associated goodwill in its retail operations throughout the United States.

91. Each related company licensing agreement required the related retail company to pay the Taxpayer a set royalty fee based upon the related retail company's retail sales.

92. The related retail companies used Taxpayers' trademarks, tradenames, and service marks and their associated goodwill in North Carolina to promote and enhance their business in North Carolina.

93. [The President of all the Taxpayers] testified that Taxpayers' trademarks were sewn in the label of the clothes sold at the retail locations in North Carolina. (T. 6/9/98, p. 75).

94. The Taxpayers' marks were used by the related retail companies located in North Carolina in their store layout, their merchandising, and their advertising.

95. The Taxpayers' ownership of the marks did not affect the use of the marks in North Carolina in the eyes of the public consumer who continued to purchase apparel from the retail locations and who were unaware that the marks had been assigned to Taxpayers.

96. [Taxpayers' President] testified that there were no changes in the relationship of the customer and the related retail companies as a result of the assignment of the marks to Taxpayers. (T. 6/9/98, pp. 149-150).

97. [Taxpayers' President] testified that as long as a related retail company operated in accordance with the licensing agreements, the day-to-day operations of the related retail company did not change with the creation of Taxpayers and the assignment of the marks. (T. 6/9/98, pp. 148-149).

98. Neither the Taxpayers nor any of the related retail companies made any public announcements notifying the public of either the formation of Taxpayers or the assignment of the marks to Taxpayers.

99. The shareholders of the [Parent Company] were not notified that the marks and the goodwill associated with the marks had been assigned to Taxpayers.

100. Employees of the related retail companies were not notified that the marks and goodwill associated with the marks had been assigned to Taxpayers.

101. After the assignment of the marks, Taxpayers depended upon the same consumer recognition and customer loyalty for the production of their income that had existed prior to the transfer of the marks.

102. At no time during the audit period did the [Parent Company's] annual reports or its Form 10-Ks disclose the formation of Taxpayers or the transfer to Taxpayers of marks valued at approximately $1.2 billion dollars.

103. The [Parent Company's] January 30, 1993, Form 10-K included a footnote "A," which reads: "[T]he names of certain subsidiaries are omitted since such unnamed subsidiaries considered in the aggregate as a single subsidiary would not constitute a significant subsidiary as of January 30, 1993."

104. The Taxpayers were not listed as subsidiaries of the [Parent Company] on the January 30, 1993 Form 10-K.

105. [Taxpayers' President] testified that the intercompany transactions occurring during the audit period between Taxpayers (producing over $1 billion in income) and the related retail companies (producing over $203 million in losses) were not significant enough to be disclosed in the footnotes of the [Parent Company's] annual report financial statements. (T. 6/9/98, pp. 117-123).

Organization of Taxpayers

106. Each of the Taxpayers elected a Board of Directors, the composition of which changed from time to time during the audit period.

107. The Board of Directors was generally the same for each Taxpayer.

108. The Taxpayers' Board of Directors consisted of [a President, an attorney, a banking executive, and an accountant from a Delaware corporate management company.]

109. [Taxpayers' President] testified that he did not believe that he had attended a board meeting of the Taxpayers in over 10 years. (T. 6/9/98, p. 160).

110. [Taxpayers President] testified that he delegated his responsibilities as board member of the Taxpayers to [the Vice-President of Taxes for the Parent Company.] (T. 6/9/98, pp. 56-57).

111. The Taxpayers compensated Board members not associated with the [Parent Company] for board meetings attended but did not compensate the Board members directly employed by the [Parent Company].

112. [Taxpayers' President] testified that neither he nor [the Vice-President of Taxes for the Parent Company,] as executives of the [Parent Company,] were permitted to receive compensation for services performed for any subsidiary of the [Parent Company]. (T. 6/9/98, p. 125).

113. [The attorney on the Taxpayers' Boards] testified that each of Taxpayers' boards on which he served compensated him fifty dollars ($50) for each board meeting attended. (T. 6/9/98, pp. 208-209).

114. The Taxpayers' expenses associated with the compensation of board members averaged $600 per year per Taxpayer.

115. The Taxpayers' Board of Directors met quarterly and they discussed such things as royalty rates, interest rates, and the authorized lending limits between the Taxpayers and the related retail companies.

116. The Taxpayers' board members authorized increased lending limits for the related retail companies as needed when the balance of the related retail companies' outstanding notes receivable reached authorized lending limits.

117. The Taxpayers' Board of Directors meetings were held at [the office of the attorney on the Board], not at the Taxpayers' leased office space.

118. The Taxpayers' corporate records, such as minutes, charters, and by-laws, were kept in [the office of the attorney on the Board], not at the Taxpayers' leased office space.

119. The Taxpayers held annual stockholders' meetings as required by Delaware law and adopted appropriate resolutions, including the election of officers and directors.

120. The Taxpayers' officers or board members did not prepare yearly business plans for the operations of Taxpayers.

121. The Taxpayers did not own or lease any real property or any tangible personal property in any state except Delaware.

122. The Taxpayers subleased shared office space from [a Delaware corporate management company] in a building located in Delaware.

123. The Taxpayers shared office equipment and office supplies.

124. The Taxpayers' primary office address was [a street in] Delaware; approximately 670 companies not related to the [Parent Company] or its wholly-owned subsidiaries list this same address as their primary office address.

125. [The attorney member of Taxpayers' Board of Directors] testified that an employee of [a Delaware corporate management company] doing work for or on behalf of Taxpayers used Taxpayers' subleased office space, "if they [were] used by anyone at all." (T. 6/9/98; p. 227).

126. The Taxpayers' rental expense associated with the subleased office space in Delaware approximated $240 per year for each Taxpayer.

127. The subleased office space was not permanently assigned to Taxpayers, but instead was rotated much like a time share-arrangement.

128. The Taxpayers hired no employees in any state.

129. The Taxpayers outsourced all of their accounting, legal, banking and administrative services.

130. The law of firm of [the attorney member of Taxpayers' Board of Directors] was hired as legal counsel for Taxpayers.

131. [The Delaware corporate management company that employed the accountant member of Taxpayers' Board of Directors] was hired as Taxpayers' accounting firm.

132. As board member and principal executive in charge of Taxpayers' accounting services, [the accountant Board member] was limited to signing checks not to exceed $500.

133. The Taxpayers contracted with [an attorney] as their trademark counsel.

134. The Taxpayers maintained checking accounts in their own names.

135. The Taxpayers used their checking accounts to pay operating expenses such as legal and accounting bills.

136. The Taxpayers did not incur substantial ordinary and necessary business expenses such as postage, telephone, or utilities for their business operations in Delaware.

137. The Taxpayers contracted with [a Delaware corporate management company], a "nexus service provider," to perform services on their behalf in Delaware.

138. Services performed by [the Delaware corporate management company] for the Taxpayers included: (1) providing officers and directors located in the State of Delaware; (2) providing office space; (3) mail forwarding; (4) filing annual Delaware Franchise Tax Returns; (5) maintaining the operating checkbook; and (6) scheduling use of a shared conference room.

Operations of the Taxpayers

139. The Taxpayers' Board of Directors agreed to license their marks to the related retail companies pursuant to licensing agreements.

140. The Taxpayers' [trademark counsel] assisted in drafting licensing agreements between the Taxpayers, as licensor, and the related retail companies, as licensees.

141. [The Taxpayers' trademark counsel] testified that all of the Taxpayers' licensing agreements were basically the same in terms of the legal requirements imposed on both the licensee and licensor. (T. 6/9/98, p. 243).

142. Each licensing agreement granted the related retail company a non-exclusive license to use all of the Taxpayer's marks in its retail operations.

143. The terms of each licensing agreement required the related retail company to pay a royalty fee of between 5% and 6% of its retail operating gross sales to Taxpayers in return for continued use of the marks.

144. Each licensing agreement allowed the related retail company to continue using the Taxpayer's name in conducting its business in the same manner as before the creation of the Taxpayer.

145. Initially, the royalty rates charged by the Taxpayers to the related retail companies were estimated by Taxpayers' trademark counsel based upon his knowledge of licensing agreements between unrelated third parties and what he believed to be a reasonable royalty based on a fair, arms-length transaction.

146. [One of the Taxpayers' expert witnesses] testified that: "When you deal with a transaction between a related party, the transaction itself is not arm's length. It cannot be - it could not have come about by an arm's length negotiation." (T. 6/11/98, pp. 68-69).

147. [Taxpayers' expert witness] testified that: "The [intercompany] agreement should have never been described as an arm's length agreement, because [it] couldn't have been." (T. 6/11/98, p. 70).

148. The Taxpayers eventually solicited trademark valuation studies from third parties which they used to establish the royalty rate charged.

149. The Taxpayers were required on occasion to amend the royalty rates charged to the related retail companies to correspond with the royalty rates determined by the third party valuation studies.

150. The value of the marks as determined by the trademark valuation reports were dependent upon the "on-going" retail operations of the related retail companies.

151. The royalty rate charged to the related retail companies as determined by the trademark valuation reports was between 5% and 6%.

152. The Taxpayers were completely dependent upon the operations of the related retail companies, including the ones located in North Carolina, for the production of their income because the royalty rates charged by the Taxpayers were based on a percentage of the related retail companies' operating sales.

153. A royalty fee was not charged for the use of the marks when a license or sublicense agreement was entered into between two Taxpayers.

154. Neither the [Parent Company] nor any of its subsidiaries licensed or sublicensed marks to foreign subsidiaries.

155. The Taxpayers' Profit and Loss Statements for the years at issue did not include any foreign source royalty income.

156. Royalty income received from foreign subsidiaries is considered gross income and fully taxable for federal corporate income tax purposes pursuant to I.R.C. § 951.

157. The only time the Taxpayers, as licensors, charged a royalty fee for the use of their marks to an affiliated company, as a licensee, was when a state tax benefit could be obtained by the licensee.

158. Each licensing agreement entered into between a related retail company, as licensee, and a Taxpayer, as licensor, required the related retail company to make quarterly royalty payments for the use of the trademarks.

159. The related retail companies did not pay the royalty fees to Taxpayers or tender any cash remittances to Taxpayers in settlement of the royalties charged.

160. Each related retail company accrued a royalty expense deduction based on a percentage of sales.

161. [Taxpayers' President] testified that the royalty payments due under the licensing agreements were made by accounting journal entry. No checks were written nor were there any physical transfers of funds between the parties. The related retail companies therefore "paid" their royalty fees to Taxpayers via accounting journal entries. (T. 6/9/98, p. 93).

162. The North Carolina taxable income of each of the related retail companies was significantly reduced by the deduction of accrued royalty expenses.

163. The Taxpayers accrued but never received payment for royalties from the respective related retail companies.

164. The accrued royalty receivables for each of the Taxpayers increased on a yearly basis corresponding closely to the amount of accrued royalty payables recorded on the books of the related retail companies.

165. The related retail companies' accrued royalty receivables were never collected.

166. The Taxpayers paid no state income tax to Delaware or any state on the accrued royalty receivables.

167. The Taxpayers' expenses were miniscule in relation to their accrued income. For example, [the] total expenses for [Taxpayer, Subsidiary Trademark Company One for] the three years at issue were $729,175, which is 0.2% of its total accrued income of $311,952,574 during the same period. Of [the] total expenses [for Taxpayer, Subsidiary Trademark Company One], legal expenses alone equaled $687,754 or 94.32% of total expenses.

168. [The] remaining expenses [of Taxpayer, Subsidiary Trademark Company One] of $41,421 for the three years at issue were immaterial and are summarized as follows: (1) Delaware franchise fees - $150; (2) accounting services - $31,052; (3) telephone expenses - $1,102; (4) rental expenses - $ 720; (5) Director's fees - $2,300; (6) custodial [expenses] - $3,520; (6) depreciation expenses - $1,862; (7) other miscellaneous expenses - $714.

169. The Taxpayers neither declared nor paid a dividend to the [Parent Company] or to any of the related retail companies during the audit period.

170. The Taxpayers entered into loan agreements whereby Taxpayers loaned their excess operating funds to the related retail companies in the form of notes receivable.

171. [Taxpayers' President] testified that the primary source of lending to the related retail companies was the earnings of Taxpayers. (T. 6/9/98, pp. 105-106).

172. [The attorney member of Taxpayers' Boards] testified that Taxpayers earned their money by charging the related retail companies royalties for the use of Taxpayers' marks and by receiving interest through loaning the related retail companies money. (T. 6/9/98, p. 179).

173. The Taxpayers' Board of Directors, including [the attorney member], authorized loans to the related retail companies in amounts comparable to the cumulative amount of royalties the related retail companies accrued during the tax year.

174. Despite authorizing loans to the related retail companies in excess of $100 billion, Taxpayers' [Attorney] Board Member testified that he had not reviewed the [Parent Company's] 10-K or its annual reports. (T. 6/9/98, p. 201).

175. The notes, which were generally 180-day promissory notes, contained standard provisions such as loan amount, interest rate, due date, and names of the parties.

176. All notes bore a market rate of interest.

177. The Taxpayers earned interest income on the notes to the related retail companies.

178. The related retail companies did not pay any outstanding principal or interest on the notes to the Taxpayers during the audit period.

179. The related retail companies accrued an interest expense deduction on their outstanding notes receivable.

180. The interest charges were settled by accounting journal entries.

181. As notes matured, the Taxpayers made the required journal entries and issued new notes to the related retail companies.

182. The Taxpayers' Board of Directors increased the authorized lending limits of the related retail companies once the related retail companies' outstanding notes receivable balances reached authorized limits.

183. The notes receivable contained no mechanism by which the Taxpayers could collect the loan debt from the related retail companies.

184. The Taxpayers made no attempt at collecting the outstanding notes receivable during the audit period.

185. The Taxpayers instructed their custodian, [Trust Company], to make no attempt to collect the outstanding notes.

186. The Taxpayers' Yearly Statements of Account reflecting the asset value of Taxpayers' outstanding notes were marked "Notes - Do Not Collect."

187. The Taxpayers did not loan money to or borrow money from any unrelated third party.

188. The North Carolina taxable income of the related retail companies was reduced by the deduction of the accrued royalty and interest expenses that were never paid.

189. The Taxpayers paid no state income tax to Delaware or any state on the royalty or interest income.

190. The Taxpayers earned 100% of their ordinary gross income from two sources: (1) the royalties charged to the related retail companies for the use of Taxpayers' marks and (2) interest earned from outstanding loans issued to the related retail companies.

191. The Taxpayers recorded royalty income totaling $957,442,830 and interest income totaling $236,728,978 from the related retail companies for the tax years at issue, broken down as follows:

YEAR	ROYALTY INCOME	INTEREST INCOME
1/92	$298,494,228	$ 58,610,029
1/93	349,880,983	56,087,605
1/94	301,067,619	122,031,344
Total	**$ 949,442,830**	**236,728,978**

192. Pursuant to I.R.C. § 1501, the Taxpayers filed a consolidated federal income tax return with [their Parent Company] for tax years ended January 1992, January 1993, and January 1994.

193. The intercompany royalty and interest transactions that occurred between Taxpayers and the related retail companies had no tax effect on the federal taxable income of the [Parent Company] because of required intercompany eliminations.

194. The intercompany royalty and interest transactions that occurred between Taxpayers and the related retail companies significantly decreased the North Carolina taxable income of the related retail companies.

The Licensing Agreements

195. The Taxpayers had incurred none of the costs and had performed none of the activities that, in any manner, had created, enhanced, or protected the value of the marks prior to the assignment of the marks to Taxpayers.

196. "Naked assignment" is a term used in trademark law that describes the assignment of a trademark without its associated goodwill.

197. [Taxpayers' trademark counsel] testified that it is illegal in the United States to assign trademarks without assigning the goodwill associated with the trademarks. (T. 6/9/98, p. 279).

198. [Taxpayers' trademark counsel] testified that goodwill is an accumulation of everything that the public perceives about a trademark - good, bad, or indifferent (T. 6/9/98, p. 280).

199. [Taxpayers' trademark counsel] testified that the goodwill the Taxpayers' assigned to the related retail companies had been created by the related retail companies. (T. 6/9/98, p. 280).

200. [Taxpayers' trademark counsel] testified that, after the assignment of the marks to the Taxpayers, the only way to maintain the goodwill associated with the marks was to use the marks. He stated that, "You use the trademark and, through the use of the trademark, you either maintain the goodwill or you don't maintain the goodwill." (T. 6/9/98, p. 280).

201. [Taxpayers' trademark counsel] testified that the trademarks were used by the related retail companies wherever they had stores and businesses. (T. 6/9/98, p. 280).

202. If Taxpayers did not take appropriate measures to monitor the related retail companies' use of their marks, Taxpayers risked abandonment of their marks, thereby enabling third parties to use the marks in whatever manner they desired.

203. The trademark law concept of "naked licensing" requires the owner of a trademark that permits another company to use its trademark to ensure that the public is not deceived with respect to the nature and quality of the goods sold under the mark.

204. [Taxpayers' trademark counsel] testified that a licensing agreement is the contractual basis by which the licensor of a trademark or tradename controls the nature and quality of the goods and services sold by a licensee using the trademark or tradename. (T. 6/9/98, p. 241).

205. [Taxpayers' trademark counsel] testified that a court could invalidate a mark and refuse to enforce a mark if the owner of the mark does nothing to protect the public trust with respect to the nature and quality of the goods sold under the mark. (T. 6/9/98, p. 237).

206. [Taxpayers' trademark counsel] testified that "the whole idea of having a related company [licensing agreement is] that there be controls over an *agent* quality of the goods . . . so that the public being accustomed with a mark being used on one line of goods or services, now that it was given to another company, would not be confused or deceived." (emphasis added) (T. 6/9/98, pp. 236-237).

207. The Taxpayers relied upon the related retail companies to ensure that the public was not deceived with respect to the nature and quality of goods sold under Taxpayers' marks.

208. The Taxpayers, owners of the marks, controlled the use of the marks in North Carolina and the nature and quality of goods sold under the marks by the related retail companies in North Carolina.

209. The related retail companies performed activities in North Carolina on behalf of the Taxpayers, including the following: (1) the preparation of quarterly inspection reports regarding the activities of the retail location; (2) establishment of store layout and design; (3) selecting the merchandise that would bear Taxpayers' marks; (4) regularly advertising apparel and merchandise in this State bearing Taxpayers' marks; (5) inspecting merchandise bearing Taxpayers' marks; (6) reporting trademark violations; and (7) establishing and maintaining Taxpayers' economic market in North Carolina.

210. The activities performed in North Carolina on behalf of the Taxpayers were significantly associated with Taxpayers' ability to establish and maintain a market in North Carolina.

211. [Taxpayers' President] testified that: "[I]t's important to protect the trademark because it's the identity of the company. It's one of the ways that you differentiate what you are as a company and what you represent; what you're selling; what you're trying to accomplish in a commercial marketplace from other people." (T. 6/9/98, p. 71).

212. The Taxpayers' commercial marketplace was in part located in North Carolina.

213. The Taxpayers' marks were displayed on the North Carolina retail locations of the related retail companies.

214. The related retail companies' activities, including marketing products bearing Taxpayer's trademarks and tradenames, maintaining the quality of the apparel sold under Taxpayers' marks, and otherwise providing retail customers with a quality shopping experience, inures to and enhances the value of Taxpayers' trademarks and tradenames in North Carolina.

215. [Taxpayers' trademark counsel] testified that he monitored "how the trademarks [were] used by the retailers" in his capacity as trademark counsel for both Taxpayers and the related retail companies. (T. 6/9/98, pp. 254-255).

216. [Taxpayers' trademark counsel] testified that representatives of the retailers as well as representatives of Taxpayers sent [him] or [his] staff into the retail stores to monitor the use of Taxpayers' trademarks by the related retail companies. (T. 6/9/98, p. 260).

217. The Taxpayers, as owners of the marks, had the power to determine which retail companies used their marks and where they could be used.

218. The Taxpayers, as owners of the marks, had the power to control to whom the marks were licensed, what license fees were charged, and when the licensing agreements expired.

219. The Taxpayers, as owners of marks, had the right to dictate the manner in which the trademarks and tradenames were displayed at the retail locations throughout North Carolina.

220. The Taxpayers knowingly and purposefully granted the retail companies a license to use their marks in connection with retail operations worldwide, including in North Carolina.

221. The licensing agreements provided that all products sold by the related retail companies bearing Taxpayers' trademarks and tradenames had to be consistent with the high standards of quality and excellence established over the years by the related retail companies with respect to their trademarks and tradenames.

222. Sections 2.1 through 2.3 of the licensing agreements provided that Taxpayers' trademarks or tradenames had to be used by the related retail companies in accordance with the following terms and conditions: (1) the retailer would use its best efforts, skill, and diligence in the operation of its Stores, and would regulate its employees so that they will be courteous and helpful to the public; (2) the retailer would use its best efforts, skill, and diligence to ensure that the quality of all apparel sold under or in connection with the trademark or tradenames would not be less than the standard of quality previously established by the retail companies; and (3) the retailer would operate its stores in accordance with reasonable business standards and would provide a standard of service not less than the standard of quality previously established by the retail companies.

223. Section 3.1 of the licensing agreements provided that each retail store operated by a related retail company had to inspect the store at least once each year and had to notify Taxpayers of the inspections in a written statement verifying that the inspections took place.

224. The Taxpayers did not physically inspect any stores in North Carolina and rarely, if ever, visited any store outside of Delaware.

225. Store employees at the North Carolina retail locations of the related retail companies acted as quality assurance inspectors and performed all inspections of apparel bearing Taxpayers' marks to ensure the quality of the goods sold under Taxpayers' marks in North Carolina.

226. The North Carolina retail operating store employees, in their capacity as quality assurance inspectors, prepared inspection reports based on the operations of the related retail companies in this State.

227. [Taxpayers' President] testified that the employees of the related retail companies performed inspections of the stores located in North Carolina in order to adhere to quality standards mandated by the licensing agreements and to demonstrate compliance with the licensors' requirements. (T. 6/9/98, pp. 86-88).

228. Section 3.1.2 of the licensing agreements provided that the related retail companies were responsible for, at their own cost and expense, correcting any deficiencies found in the quality of the products sold bearing Taxpayers' trademarks.

229. Section 4 of the licensing agreements provided that the related retail companies had to make available to Taxpayers samples of all advertising or other literature, packages, and labels bearing Taxpayers' tradename or trademarks.

230. [Taxpayers' trademark counsel] testified that he monitored all advertising associated with Taxpayers' trademarks and tradenames in his capacity as trademark counsel for both the related retail companies and Taxpayers. (T. 6/9/98, pp. 254-255).

231. In reviewing the advertising samples submitted by the related retail companies, [Taxpayers' trademark counsel] looked to ensure that Taxpayers' marks were used in a consistent manner and to ensure that the use did not infringe on other marks.

232. Section 11.1 of the licensing agreements required the related retail company to defend Taxpayers' marks against infringement by third parties at its own cost and expense.

233. Section 11.2 of the licensing agreements provided that if the related retail company was made party to a legal proceeding based upon a claim that one of Taxpayers' marks infringed upon a third party's mark, the related retail company had to, at its own cost and expense, defend its use of the licensed mark.

234. Prior to the formation of Taxpayers, the marks associated with the related retail companies were registered, monitored, and defended against infringement by the related retail companies themselves.

235. The Taxpayers continually updated the trademark filings and registrations with the United States Patent and Trademark Office in order to ensure that Taxpayers' rights in the marks were preserved.

236. [Taxpayers' trademark counsel] testified that his office filed with the United States Patent and Trademark Office every six years an affidavit "saying that [the] trademarks [were] still in use. Otherwise, [the trademarks would] be automatically cancelled." (T. 6/9/98, pp. 262-263).

237. [The President of the Parent Company] testified that the related retail companies located in North Carolina used Taxpayers' marks on a daily basis. (T. 6/9/98, pp. 74-75).

The Assessments

238. The [Parent Company] was contacted in March, 1995 by Mr. Al Milak, Revenue Field Auditor in the Interstate Audit Division, regarding the activities of the [Parent Company] and its affiliates in this State.

239. An on-site audit for corporate franchise and income tax was conducted in August 1995.

240. The auditors determined that Taxpayers, subsidiaries of the [Parent Company], were doing business in this State and subject to corporate income and franchise taxation in this State pursuant to G.S. 105-114, 105-122, 105-130.1, and 105-130.3.

241. The Taxpayers were not filing corporate franchise and income tax returns.

242. The auditor requested on October 23, 1995 that Taxpayers file and pay North Carolina franchise and income tax, apportioning their income liability to this State as an excluded corporation pursuant to G.S. 105-130.4(a)(4) and 105-130.4(r).

243. The Taxpayers did not voluntarily file North Carolina franchise and income tax returns and refused to provide the auditors with sufficient information necessary to compute Taxpayers' North Carolina corporate liability.

244. Jeopardy assessments of corporate income and franchise taxes were issued for tax years January 1992, January 1993, and January 1994 under the authority of G.S. 105-241.1(g) on March 26, 1996 and on April 2, 1996.

245. The Taxpayers were assessed income and franchise taxes calculated on royalty and interest income derived from sources within North Carolina.

246. For each Taxpayer during the audit period, the franchise assessments of tax, penalties, and interest are as follows:

Franchise Tax Assessments

[Taxpayer, Subsidiary Trademark Company One]	$ 124,966
[Taxpayer, Subsidiary Trademark Company Two]	$ 3,963
[Taxpayer, Subsidiary Trademark Company Three]	$ 1,025
[Taxpayer, Subsidiary Trademark Company Four]	$ 37,264
[Taxpayer, Subsidiary Trademark Company Five]	$ 37,296
[Taxpayer, Subsidiary Trademark Company Six]	$ 31,949
[Taxpayer, Subsidiary Trademark Company Seven]	$ 44,142
[Taxpayer, Subsidiary Trademark Company Eight]	$ 1,071
[Taxpayer, Subsidiary Trademark Company Nine]	$ 27,176
Total	**$ 308,852**

247. For each Taxpayer during the audit period, the corporate income tax assessments of tax, penalties, and interest are as follows:

Income Tax Assessments

[Taxpayer, Subsidiary Trademark Company One]	$	1,331,052
[Taxpayer, Subsidiary Trademark Company Two]	$	116,401
[Taxpayer, Subsidiary Trademark Company Three]	$	58,452
[Taxpayer, Subsidiary Trademark Company Four]	$	953,765
[Taxpayer, Subsidiary Trademark Company Five]	$	580,231
[Taxpayer, Subsidiary Trademark Company Six]	$	766,775
[Taxpayer, Subsidiary Trademark Company Seven]	$	128,766
[Taxpayer, Subsidiary Trademark Company Eight]	$	82,479
[Taxpayer, Subsidiary Trademark Company Nine]	$	666,909
Total	**$**	**4,684,830**

248. The jeopardy income tax assessments were based on the best information available to the auditor. That information was Taxpayers' separate entity, "pro-forma" federal taxable income, Federal Line 28, as reflected on the [Parent Company's] consolidated 1120 tax return.

249. The proposed assessments were based on the State's assertion that Taxpayers were doing business in North Carolina by virtue of their activities of licensing intangibles for use in North Carolina and using in-state representatives in furtherance of their business activities.

250. On April 22, 1996, Taxpayers timely protested the proposed corporate income and franchise tax assessments and reserved the right to a hearing before the Secretary of Revenue.

251. An application for hearing was timely filed on August 18, 1997.

252. An Administrative Tax Hearing before the Secretary of Revenue was conducted by the hearings' officer on Monday, June 9 through Wednesday, June 11, 1998 in the Revenue Building on 501 North Wilmington Street.

253. On June 11, 1998, the hearings' officer granted Taxpayers' motion to waive all penalties associated with all three tax years at issue.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. The Taxpayers are subject to corporate income taxation in this State pursuant to G.S. 105-130 *et seq*.

2. The Taxpayers are subject to franchise taxation in this State pursuant to G.S. 105-114 *et seq*.

3. G.S. 105-130.3 imposes a tax upon the State net income of every C corporation doing business in this State.

4. The Taxpayers are C corporations.

5. G.S. 105-122 imposes a franchise tax upon every corporation domesticated under the laws of this State or doing business in this State.

6. The Taxpayers are not domesticated under the laws of this State.

7. For franchise tax purposes, "doing business" is defined as "[e]ach and every act, power or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges granted by the laws of this State."

8. North Carolina Administrative Rule 17 NCAC 5C .0102 was promulgated by the Secretary of Revenue under authority of G.S. 105-262 and 105-264 to interpret G.S. 105-130.3.

9. Administrative Rule 17 NCAC 5C .0102 is *prima facie* correct.

10. Administrative Rule 17 NCAC 5C .0102 defines "doing business," in pertinent part, as "the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to . . . the owning, renting, or operating of business or income-producing property in North Carolina including, but not limited to . . . [t]rademarks [and] tradenames."

11. The Taxpayers own intangible property in the form of trademarks, tradenames, and service marks and the goodwill associated with these marks.

12. There is no such thing as property in a trademark except as a right appurtenant to an established business or trade in connection with which the mark is employed.

13. A trademark has no independent significance apart from the goodwill it symbolizes; if there is no established business and no goodwill, a trademark symbolizes nothing.

14. A trademark cannot exist apart from the going business in which it is used.

15. Trademark rights are wholly dependent upon actual use.

16. The actual use of a symbol as a trademark in the sale of goods creates and builds up rights in a mark.

17. Lack of actual use can result in loss of legal rights in the mark, known as "abandonment."

18. The Taxpayers licensed their intangible property, in the form of trademarks, tradenames, service marks and associated goodwill, to the related retail companies for use in this State.

19. If a trademark owner licenses the mark, the owner must control the nature and quality of the goods sold under the mark and must at all costs avoid deceiving the public.

20. The concept of quality control has been incorporated into the Lanham Act by the "related company" doctrine.

21. Under the Lanham Act, a "related company" is "any person whose use of the mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used."

22. If the owner controls the use of the mark by the licensee, the owner obtains the benefits of Section 5 of the Lanham Act, and the licensee's use of the mark is attributed to and inures to the benefit of licensor, the owner of the mark.

23. If the owner of a trademark does not exercise sufficient actual control over the use of the mark by the licensee, the owner loses its rights in the mark through abandonment.

24. The trademark owner must exercise *actual* control over the licensee's use of the mark. Mere paper control, such as a quality control provision in a licensing agreement, without actual control is insufficient. The mere legal right to control is insufficient, as is the voluntary exchange of information.

25. Under the related company doctrine, if the Taxpayers exercised sufficient actual control over the operations of the related retail companies in North Carolina with regard to their use of the marks and the nature and quality of the goods sold

under the marks, the use by the related retail companies in North Carolina is attributed to and inures to the benefit of the Taxpayers.

26. Absent sufficient actual control by the Taxpayers over the related retail companies' use of the marks in North Carolina and the nature and quality of the goods sold under the marks in this State, the use of the marks by the related retail companies is not attributed to the Taxpayers.

27. If use by the related retail companies of Taxpayers' marks is not attributed to Taxpayers, the marks would be abandoned.

28. The licensing agreements between Taxpayers and the related retail companies created a contractual agency relationship between Taxpayers and the related retail companies.

29. The Taxpayers exercised actual control over the licensees' use of the marks at the 130 North Carolina retail locations and over the nature and quality of the goods sold under the marks by the licensees at these locations.

30. The related retail companies are "related retail companies" under the related company doctrine of trademark law.

31. The related retail companies regularly and systematically used the Taxpayers' marks at the 130 retail locations in North Carolina.

32. The intangibles owned by the Taxpayers and used at the 130 retail locations in this State have acquired a business situs in North Carolina.

33. The Taxpayers own income-producing property in North Carolina.

34. The regular and systematic use of the Taxpayers' marks by the related retail companies at the 130 retail locations in North Carolina is attributed to and inures to the benefit of Taxpayers, thereby protecting and preserving the value and existence of the marks and associated goodwill, Taxpayers' only assets.

35. The use of Taxpayers' marks by the related retail companies in North Carolina is essential to the continued existence of the marks.

36. The quality control and trademark protection activities performed by employees of the related retail companies in North Carolina to protect Taxpayers' marks are attributed to and inure to the benefit of Taxpayers.

37. The activities performed by employees of the related retail companies in North Carolina to assist in maintaining the goodwill associated with Taxpayers' marks are attributed to and inure to the benefit of Taxpayers.

38. The related retail companies, in performing the activities of quality control and protection and preservation of Taxpayers' marks and associated goodwill, act as Taxpayers' agents or representatives in North Carolina.

39. The activities of the related retail companies, acting as Taxpayers' agents or representatives, enable Taxpayers to maintain and enhance a market in this State for merchandise bearing Taxpayers' marks.

40. The Taxpayers' primary source of income, the royalty fees, is dependent upon business activity conducted by employees of the related retail companies in North Carolina, which activity Taxpayers control.

41. The Taxpayers purposefully availed themselves of the benefits of an economic market in North Carolina.

42. The Taxpayers regularly and systematically exploited the North Carolina marketplace for economic gain.

43. The Taxpayers' business activities were purposefully directed towards residents of North Carolina.

44. The Taxpayers operate income-producing business property in North Carolina.

45. The Taxpayers are operating a business activity or enterprise in this State for economic gain.

46. The Taxpayers are "doing business" in this State for corporate income tax purposes.

47. The Taxpayers are "doing business" in this State for corporate franchise tax purposes.

48. The Taxpayers received more than 50% of their income from investments in or dealing in intangible property.

49. The Taxpayers are "excluded corporations" under G.S. 105-130.4(a)(4).

50. The Taxpayers must apportion their business income using the sales factor as determined under G.S. 105-130.4(a)(l).

51. The proposed assessments of corporate income and franchise tax were proper under G.S. 105-241.1.

DECISION

I. SUMMARY OF FACTS

This case involves nine non-domiciliary corporations ("Taxpayers") that own trademarks, tradenames, service marks ("marks"), and the goodwill associated with these marks. This intangible property was transferred to the Taxpayers from their retail affiliates ("related retail companies"). The Taxpayers are wholly-owned subsidiaries of the [Parent Company, a non-domiciliary corporation]. The related retail companies consist of the [Parent Company] and eight wholly-owned subsidiaries of the [Parent Company]. The chart in Finding Of Fact #12 shows the relationships between these companies. The related retail companies are located in this State and pay corporate income and franchise taxes here.

The Taxpayers were incorporated in Delaware to hold the marks formerly owned by the [Parent Company] and its various wholly-owned retail subsidiaries. The marks owned by the Taxpayers include [nine marks]. The marks are a form of intangible personal property. The Taxpayers do not own or lease any real property or any tangible personal property in any state except Delaware. The Taxpayers do not have any employees in any state.

The Taxpayers received the marks they own in separate I.R.C. § 351 tax-free exchanges with the related retail companies. In these exchanges, the related retail companies transferred the marks to the Taxpayers for little or no consideration. The Taxpayers then entered into licensing agreements with the related retail companies authorizing the related retail companies to use the marks in exchange for royalty payments to Taxpayers.

During the years at issue, the [Parent Company] was primarily engaged in the retail sale of men's, women's, and children's clothing and accessories throughout the United States, including North Carolina. During these years, the [Parent Company] and its related retail companies operated over 130 retail locations in North Carolina. On a daily basis, these 130 plus retail locations used the Taxpayers' marks in their signage, store layout, merchandising, and advertising. The Taxpayers' marks, for example, were permanently affixed to these retail locations. In addition, these locations performed various activities on behalf of Taxpayers needed to protect the marks in accordance with trademark law and to maintain and enhance a market for merchandise bearing Taxpayers' marks. These activities included selecting merchandise to bear Taxpayers' marks and inspecting the merchandise to ensure appropriate quality.

The corporate structure of the Taxpayers developed over a number of years. In the early 1970's, at a time when specialty retailing was emerging, the [Parent Company] began taking a strong position in what was termed a "private label." Instead of purchasing nationally-branded goods from the garment district in New York, the [Parent Company] had goods produced with its own label, its trademark, sewn inside the garment. In the course of its retail operations, the private label [trademark] developed name recognition within the apparel industry. The [Parent Company] incurred substantial expenses in the development of [its] trademark, which were deducted from [its] gross income in determining its federal taxable income. The [Parent Company's] North Carolina taxable income was also reduced by the expenses associated with the development of its marks because the [Parent Company's] North Carolina net income was derived from federal taxable income.

In December 1980, the [Parent Company] formed a wholly-owned subsidiary, [Taxpayer, Subsidiary Trademark Company One], in Delaware and transferred its domestic (United States) marks, together with the goodwill associated with the marks, to [Taxpayer, Subsidiary Trademark Company One] for 100 shares of [the Company's] $1.00 par value common stock using I.R.C. § 351. [Taxpayer, Subsidiary Trademark Company One] then licensed the trademarks back to the [Parent Company, which was also Related Retail Company One] for use in the [Parent Company's] domestic operations and charged the [Parent Company] a royalty to use the marks based on a percentage of the [Parent Company's] retail sales.

Initially, a royalty rate of 5% was determined to be reasonable by Taxpayers' trademark counsel based on his experience with third-party licensing agreements. At a later date, the Taxpayers solicited trademark valuation studies from third parties in order to prevent the appearance of the transactions being "shams" or not being arms-length. The royalty rate for the [trademark] was determined by the third party to be 6%. The Taxpayers did not receive an initial trademark valuation from third parties determining the actual worth of the trademark prior to the assignment and license back of the marks between the Taxpayers and the related retail companies.

Subsequent to the formation of [Taxpayer, Subsidiary Trademark Company One] in late 1980, the [Parent Company] acquired other retail businesses that owned trademarks, tradenames, and service marks. Those businesses were [Related Retail Companies Two, Five, Six, and Nine. The Parent Company also incorporated four of its business segments. Three of these, Related Retail Companies Three, Four, and Seven, were incorporated as wholly-owned subsidiaries of the Parent Company and

one of these, Related Retail Company Eight, was incorporated as a wholly-owned subsidiary of Related Retail Company Four.] As was the case with [Taxpayer, Subsidiary Trademark Company One], the [Parent Company incorporated eight separate subsidiaries -- Taxpayers, Subsidiary Trademark Companies Two through Nine] to hold the marks of those [acquired and separately incorporated] businesses. In separate transactions, the related retail companies transferred their domestic (United States) marks to the Taxpayers, together with the goodwill associated with the marks, for little or no consideration. The Taxpayers then licensed the marks back to the related retail companies for use in the related retail companies' stores. These marks were actively used by the related retail companies located in North Carolina both prior to and after the tax-free exchanges.

After assigning their domestic (United States) marks to the Taxpayers, the related retail companies, pursuant to related company licensing agreements, licensed back the marks from the Taxpayers for use in their retail operations in the same manner in which they had been used prior to the transfer. In fact, at the retail locations, nothing changed with the transfer of the marks to Taxpayers. The licensing agreements executed by the Taxpayers and the related retail companies required the related retail companies to pay the Taxpayers a royalty fee based on a percentage of the companies' retail operating gross sales. The royalty rate charged by the Taxpayers to the related retail companies for the years at issue was between 5% and 6%. During the fiscal years ended January 31, 1992 through January 31, 1994, the Taxpayers recorded total royalty income received from the related retail companies in the amount of $949,442,830.

In separate transactions, the Taxpayers loaned money earned from the royalty payments back to the related retail companies for use in their retail operations. The loan agreements allowed the Taxpayers to charge the related retail companies a market rate of interest on outstanding loan balances. During the fiscal years ended January 31, 1992, through January 31, 1994, the Taxpayers recorded total interest income received from the related retail companies in the amount of $236,728,978.

The net effect of both of these separate transactions upon each related retail company was to significantly reduce the company's taxable income in the states in which it did business by both the royalty payment and the interest expense charged by the Taxpayers. The Taxpayers did not pay tax to any state on the income received from the related retail companies.

II. TRADEMARK LAW PRINCIPLES

A discussion of trademark law principles is necessary to an understanding and resolution of the issues of this case. Trademarks, tradenames, and service marks are forms of intellectual property that are regulated under the Lanham Act, 15 U.S.C. §§ 1051 *et. seq.,* and recognized and protected under common law. The Lanham Act defines "trademark" to "include any word, name, symbol, or device, or any combination thereof . . . used by a person, or . . . which a person has a bona fide intention to use in commerce and applies to register on the principal register established by the Act, to identify and distinguish his or her goods from those manufactured or sold by others and to indicate the source of the goods." 15 U.S.C. § 1127. The Lanham Act defines "tradename" as "any name used by a person to identify his or her business or vocation." *Id.*

Trademarks are regarded as "property." J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, § 18.01[1] (4th Ed. 1998). However, they enjoy a unique status under the law. The United States Supreme Court has characterized the nature of trademarks as follows:

> There is no such thing as property in a trade-mark except as a right appurtenant to an established business or trade in connection with which the mark is employed. The law of trademarks is but a part of the broader law of unfair competition; the right to a particular mark grows out of its use, not its mere adoption; its function is simply to designate the goods of a particular trader and to protect his good will against the sale of another's product as his; and it is not the subject of property except in connection with an existing business.

United States Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97 (1918).

A trademark "is merely a symbol of goodwill." MCCARTHY, § 17.03[2]. Trademarks and the goodwill of the business with which they are associated are "as inseparable as Siamese Twins who cannot be separated without death to both." *Id.* A trademark "has no independent significance apart from the goodwill it symbolizes." *Id.* "If there is no business and no goodwill, a trademark symbolizes nothing." *Id.*

Another noted trademark law expert notes:

> There is a highly unique legal relationship between trademarks and the goodwill they come to represent. This relationship is fundamental to the law of trademarks, and several important consequences flow from it. First, a trademark may not be assigned apart from the goodwill it symbolizes. Second, a trademark cannot exist apart from the going business in which it is used. The trademark and the goodwill it represents can thus be said to be inseparable. Since there can be no goodwill for the trademark to symbolize without such going business and corresponding use of the trademark, trademark rights in the United States, at least, are wholly dependent on actual use.

JEROME GILSON, TRADEMARK PROTECTION AND PRACTICE, Vol. 1, § 1.03[7][b].

Trademarks must continue to be used in connection with an existing business to retain their status as a protected property right. Otherwise, they may be considered abandoned. According to Professor McCarthy, "[i]t is the actual usage of a symbol as a 'trademark' in the sale of goods which creates and builds up rights in a mark. Therefore, lack of actual usage of a symbol as a 'trademark' can result in a loss of legal rights . . . known as 'abandonment.'" MCCARTHY, § 17.03[1].

Because of the inseparability of the trademark and goodwill it symbolizes, a trademark cannot be sold or transferred without the goodwill. An assignment of the mark alone is referred to as a "naked assignment" and is invalid. *Visa U.S.A., Inc. v. Birmingham Trust National Bank*, 696 F.2d 1371 (Fed. Cir. 1982), *cert. denied*, 464 U.S. 826 (1983); *see also* 15 U.S.C. § 1060.

A trademark license is a contractual arrangement whereby a trademark owner permits another to use the owner's trademark under circumstances where, but for the license, the other would be an infringer. GILSON, § 6.01[2]. The moment a trademark owner permits someone else to use its mark, trademark law and overriding public interest impose a new obligation on the owner with respect to the quality of the goods sold under the trademark. The owner must stringently control the nature and the quality of the goods sold under the mark by the licensee and must at all costs avoid deceiving the public. GILSON, § 6.01[4].

Early trademark decisions generally held that a trademark could not be licensed. *See, e.g.*, *Macmaham Pharmacal Co. v. Denver Chem. Mfg. Co.*, 113 F. 468 (8th Cir. 1901). These cases took the view that a trademark could designate only a single source of goods. GILSON, § 6.01[4]. The "source" theory evolved into the "guarantee of

quality" theory over time, however, and the concept of quality control emerged in judicial decisions permitting licensing if certain controls were maintained by the licensor. If the trademark owner exercised adequate control over the nature and quality of the goods sold by the licensee under the mark, the public would not be deceived, but would obtain goods of uniform quality from both sources. GILSON, § 6.01[4].

The concept of quality control was incorporated in the Lanham Act in 1946 by the establishment of the "related company" doctrine. GILSON, § 6.01[4]. Under the Lanham Act, a "related company" is defined as "any person whose use of the mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used." 15 U.S.C. § 1127. The rationale for the "related company" doctrine has been described as follows:

> Without the requirement of control, the right of a trademark owner to license his mark separately from the business in connection with which it has been used would create the danger that products bearing the same trademark might be of diverse qualities . . . . Thus, unless the licensor exercises supervision and control over the operations of its licensees the risk that the public will be unwittingly deceived will be increased and this is precisely what the Act is in part designed to prevent . . . . Clearly the only effective way to protect the public where a trademark is used by licensees is to place on the licensor the affirmative duty of policing in a reasonable manner the activities of his licensees.

GILSON, § 6.01[4]. The "related company" doctrine has been described as follows:

> The Lanham Act does not expressly require a trademark licensor to exercise quality control. . . . Instead, it operates through the "related companies" doctrine on a reward-punishment incentive system. If the licensor controls quality adequately, the licensee becomes a "related company" and the licensor obtains the benefits of Section 5. If he does not, and the mark thereby ceases to function as an identification of source, he loses his trademark rights through abandonment.

GILSON, § 6.01[5]. Section 5 of the Lanham Act provides:

> Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or the applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such a manner as to deceive the public.

15 U.S.C. § 1055.

According to Gilson, "[t]oday, control over the nature and the quality of the goods or services is the touchstone of a valid trademark license." GILSON, § 6.01[4]. However, "[i]f control is not adequately maintained, the license is a 'bare' or 'naked' license and the trademark owner faces possible abandonment of his trademark rights." GILSON, § 6.01[4]. Under Section 45 of the Lanham Act, the licensor has the duty to exercise control over both the "nature" and the "quality" of the goods sold under the mark by the licensee. GILSON, § 6.01[5]. Regarding the "nature" of the goods sold, the licensor must specify the products with which the licensed marks are to be used. *Id*. If it does not, the marks may be deemed abandoned. *Id*. The trademark owner must also prevent the licensee from using the mark on products other than those the licensor has specified. *Id.* Under this principle, a licensor must prosecute a licensee for trademark infringement if the licensee uses the mark on goods not specified by the licensor. *Id.*

The Act "contemplates *actual control.*" GILSON, § 6.01[5] (emphasis in original). The mere legal right to control is not sufficient. GILSON, § 6.01[5]. Likewise, a voluntary exchange of information is insufficient. *Philip Morris, Inc. v. Imperial Tobacco Co.,* 282 F.Supp. 931 (E.D. Va. 1967), *aff'd*, 401 F.2d 179 (4th Cir. 1968), *cert. denied*, 393 U.S. 1094 (1969).

Furthermore,

> [s]o long as quality control is in fact exercised, there is no legal requirement that the trademark license agreement be in writing or, if it is,

> that it contain an express provision on the subject. At the same time, mere "paper control," a quality control provision in the licensing agreement without actual control, is insufficient. The crucial question is whether the licensor in fact exercises sufficient control to guarantee the quality of the goods or services sold to the public under the trademark.

GILSON, § 6.01[5]. The significance of control cannot be overstated. An uncontrolled or "naked" license constitutes an abandonment of the licensor's rights in the mark. GILSON, § 6.01[6].

The concept of use is also crucial. Actual use of the mark is necessary to retain its status as a protected property right. Absent use, the mark is abandoned. Nonuse for two consecutive years is *prima facie* evidence of abandonment. 15 U.S.C. § 1127. Unless the use of the mark by the licensees (the related retail companies in this case) inures to the benefit of the licensors (the Taxpayers in this case), the marks are abandoned. Use by the licensee can only inure to the benefit of the licensor if the licensee is a "related company" under the Lanham Act. In order to be a related company, however, and obtain the concomitant benefits, the licensor must in fact exercise sufficient actual control over the licensee's use of the marks and the nature and quality of the goods sold under the mark.

Thus, under applicable principles of trademark law, unless the Taxpayers exercised actual control, in fact, over the use of the marks by the related retail companies in North Carolina, and the nature and quality of the goods sold under the marks by the related retail companies in North Carolina, the licenses by the Taxpayers to the related retail companies would have constituted "naked" licenses and the Taxpayers' rights in the marks would have been abandoned. If the Taxpayers exercised sufficient control in fact over the related retail companies, however, the use of

the marks by the related retail companies would have inured to the benefit of the Taxpayers and the marks would not have been abandoned.

III. DOING BUSINESS IN NORTH CAROLINA

The Department assessed Taxpayers for corporate income and corporate franchise tax for the three fiscal years ending on January 31, 1992, 1993, and 1994. Taxpayers had not filed a return for those years. The Taxpayers contend that they were not doing business in North Carolina in those tax years and the Department contends that they were.

I find that the Taxpayers were doing business in this State during those years and are therefore subject to this State's corporate income tax and corporate franchise tax. I further find, for reasons discussed below, that the assessments for tax years 1992 and 1993 should nevertheless be canceled. The assessment for tax year 1994 is upheld. At the administrative hearing held on June 11, 1998, I granted Taxpayers' motion to waive all penalties associated with tax year 1994, because, in my opinion, Taxpayers acted reasonably and under advice of counsel in their interpretation of the applicable law.

G.S. 105-130.3 imposes a tax on the State net income of every C corporation doing business in this State. G.S. 105-122 imposes a franchise tax on every corporation incorporated or domesticated under the laws of this State or doing business in this State. The term "doing business" is defined by statute for corporate franchise tax purposes and is defined by administrative rule for corporate income tax purposes. G.S. 105-114(b)(3), which is in the franchise tax laws, defines "doing business" as "[e]ach and every act, power, or privilege exercised or enjoyed in this State, as an incident to,

or by virtue of the powers and privileges granted by the laws of this State."

Administrative Rule 17 NCAC 5C .0102 reads, in relevant part, as follows:

> **.0102 DOING BUSINESS DEFINED**
>
> (a) For income tax purposes, the term "doing business" means the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to, the following:
>
> * * *
>
> (5) the owning, renting, or operating of business or income producing property in North Carolina including, but not limited to, the following:
>
> (A) Realty;
> (B) Tangible personal property;
> (C) Trademarks, tradenames, franchise rights, computer programs, copyrights, patented processes, licenses.

The non-exclusive list of examples in subparts (5)(A) through (5)(C) of the rule was added effective November 2, 1992. The remainder of the rule has been in effect since at least 1963. It was first published in the Department's Rules and Bulletins and was incorporated in the North Carolina Administrative Code by the Attorney General's Office in 1976.

The Taxpayers insist that the administrative rule must be given prospective treatment only and cannot apply to the first two fiscal years. They argue that because the first two fiscal years began prior to the effective date of the 1992 amendment, the rule cannot apply and the assessments for those years must be vacated.

The Department responds that even though the specific example set forth in 17 NCAC 5C .0102(a)(5)(C) was not effective until November 2, 1992, the "doing business" rule was published since at least 1963. Thus, the Secretary's interpretation of G.S. 105-130.3 that the operation of a business activity or enterprise in this State for economic

gain constitutes "doing business" for corporate income tax purposes was published well prior to 1992.

The Taxpayers nevertheless argue that the rule did not provide adequate notice that operation of their particular type of business enterprise or activity in this State for economic gain would subject them to tax. Their argument continues that the 1992 amendment of the rule constituted a change in policy and therefore must be given prospective treatment only under G.S. 105-264.

I find that the 1992 amendment to the rule did not constitute a change in policy by the Department. The administrative rule, both prior to and after the 1992 amendment, explicitly stated that the operation of a business activity or enterprise in North Carolina for economic gain, including but not limited to, the owning, renting, or operating of business or income-producing property in North Carolina constitutes "doing business" for corporate income tax purposes.

I further find, however, that the subject of when a corporation is doing business in a state was and continues to be a subject of nationwide debate among states, taxpayers, scholars, jursists, and commentators. Under the specific facts of this case, I find it reasonable to cancel the assessments for the fiscal years ending January 31, 1992 and 1993, which began prior to the effective date of the 1992 amendment to the rule that added the specific example for trademarks and tradenames.

G.S. 105-264 authorizes the Secretary to adopt administrative rules interpreting all laws she administers and states that an interpretation by the Secretary is *prima facie* correct. Administrative Rule 17 NCAC 5C .0102 was adopted by the Secretary to interpret G.S. 105-130.3, a law she administers, and is therefore *prima facie* correct.

The administrative rule properly does not attempt to set forth an all-inclusive definition of “doing business” for corporate tax purposes. The North Carolina Supreme Court held, in an early franchise tax case, that “[n]o all-embracing rule as to what is ‘doing business’ has been laid down. The question is one of fact, and must be determined largely according to the facts of each individual case, rather than by the application of fixed, definite, and precise rules.” *C.T.H. Corp. v. Maxwell,* 212 N.C. 803, 810, 195 S.E. 36, 40 (1938).

In *C.T.H. Corp*., the Court noted that the expression “doing business in this State” for purposes of a service of process statute “means engaging in, carrying on, or exercising in this State, some of the things, or some of the functions, for which the corporation was created.” *Id*., 212 N.C. at 811, 195 S.E. at 41. Significantly, the Court then observed that “[a] broader meaning is to be given the words ‘doing business’ as used in a tax statute.” *Id.*

Under Administrative Rule 17 NCAC 5C .0102(a), a taxpayer is considered to be “doing business” in this State if it operates any business enterprise or activity in this State for economic gain, including but not limited to the owning, renting, or operating of business or income-producing property in North Carolina. The Taxpayers argue that the rule exceeds the scope of the statute because it expands the definition of “doing business” beyond what is permitted by the statue. (Taxpayers’ Post Hearing Brief at 36). According to Taxpayers, the Department’s interpretation could subject an individual celebrity to tax just because the celebrity receives an economic benefit from royalties on products sold in the state. (*Id.)*

In response, the Department pointed out several significant distinctions between the hypothetical examples raised by Taxpayers and the facts of this case, most notably that the administrative rule does not define "doing business" merely as deriving an economic benefit from the State. Instead, subsection (a) of the rule sets forth the basic premise that "doing business" means the operation of a business activity or enterprise in North Carolina for economic gain. (Department's Post-hearing Brief at 27-28; Department's Responses to Questions at 3).

Although in some isolated circumstances, it may be possible that the rule could conceivably be interpreted in such a manner so as to impose a tax upon an entity that may not be properly taxable as Taxpayers argue, that is not the situation here and those facts are not before me. In this case, the Department has properly applied the applicable statues and administrative rule; the Taxpayers are "doing business" in this State because they are operating a business activity or enterprise in North Carolina for economic gain. There is no "overreaching" under the facts of this case. The Taxpayers' activities fall within the plain language of the rule.

The Taxpayers own valuable intangible property in the form of trademarks, tradenames, and service marks and the goodwill associated with the marks. This property is business or income-producing property. The property is intangible property and, under applicable principles of law, has acquired a business situs where it is used. *See Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936). The Taxpayers' property is used in North Carolina. Consequently, Taxpayers own business or income-producing property in North Carolina.

Under trademark law, Taxpayers' property cannot exist apart from an established business in which it is used; if the property is not used, the property is considered abandoned and ceases to exist. The Taxpayers' property therefore exists only where it is used. The Taxpayers' property is used extensively in North Carolina in connection with established businesses. These established businesses are the 130 plus North Carolina retail locations of Taxpayers' related retail companies.

The Taxpayers' marks are permanently affixed to the retail locations and appear on the labels of merchandise sold at the locations. As a result, Taxpayers' marks are used at the retail locations each time employees at the locations sell merchandise. This use, which occurs in North Carolina, preserves the existence of Taxpayers' property.

The Taxpayers rent their intangible property in North Carolina by licensing the use of the property to their related retail companies, which operate over 130 retail locations in North Carolina. The licensing agreements require the related companies to make royalty payments to Taxpayers for the use of Taxpayers' property. The Taxpayers purposefully license their property for use in this State. The Taxpayers in fact earn significant royalty income from the licensing agreements. The Taxpayers therefore license business or income-producing property in North Carolina.

The Taxpayers operate business or income-producing property in North Carolina through the licensing agreements with their related retail companies. These agreements created a contractual agency relationship between the related retail companies and the Taxpayers.

The related retail companies are affiliates of Taxpayers based on corporate structure and are also related companies of Taxpayers within the "related company"

doctrine of the Lanham Act. Under that doctrine, an owner of a trademark that licenses the trademark for use by another must control the nature and quality of the goods and services sold under the trademark and must protect the mark from unauthorized use by others in order for the licensee's use of the trademark to be attributed to the owner, thereby preserving the existence of the trademark.

As licensors, therefore, Taxpayers must exercise actual control in fact over the use of their marks by their licensees and over the quality of goods and services sold under the marks or risk losing the marks. Through this control, the use of the marks in North Carolina by the related retail companies is attributed to and inures to the benefit of each of the Taxpayers, thus protecting the value and preserving the existence of their only assets. Because of this control, the use of the marks in North Carolina by the retail locations of the related retail companies is attributed to and inures to the benefit of Taxpayers.

Accordingly, the Taxpayers exercise control over the marks through the licensing agreements between the Taxpayers and the related retail companies. These agreements required the related retail companies to maintain and protect the standards of quality established by the Taxpayers, to protect and enhance the goodwill associated with the marks, and to ensure proper use of the marks. Pursuant to the licensing agreements, the related retail companies perform activities in this State that fulfill Taxpayers' obligations to control the quality and nature of goods and services sold under Taxpayers' marks and to protect the marks from unauthorized use by others.

Because Taxpayers have no employees, Taxpayers must rely on their related retail companies to provide the required control. The retail locations of the related retail

companies affix the marks to their locations, select the merchandise that will bear a label with the marks, inspect the merchandise to ensure that it is of suitable quality to bear the marks, sell merchandise bearing the marks, prepare quarterly inspection reports about activities at the retail locations, establish a store layout and design that is appropriate to bear the marks, and report trademark violations to Taxpayers.

The activities of the related retail companies also result in maintaining and enhancing a market in North Carolina for merchandise bearing Taxpayers' marks. Through these activities, Taxpayers purposefully avail themselves of the benefits of an economic market in North Carolina. Taxpayers' primary source of income, the royalties, was dependent upon the activities conducted by employees at the 130 North Carolina retail locations.

In summary, Taxpayers are doing business in North Carolina because they are operating a business enterprise or activity in North Carolina for economic gain. The Taxpayers' activities fall within all three of the possible methods set out in Administrative Rule 17 NCAC 5C .0102(a)(5) by which an entity could be doing business in this State. If the Taxpayers' activities fit any one of these methods, the Taxpayers would be doing business in North Carolina. The Taxpayers own business or income-producing property in North Carolina, the Taxpayers license business or income-producing property in North Carolina, and the Taxpayers operate business or income-producing property in North Carolina.

IV. EXCLUDED CORPORATIONS

Because it has been determined that the Taxpayers are properly subject to the corporate income and franchise tax, a determination must be made as to whether they are "excluded corporations" as defined in G.S. 105-130.4(a)(4). If the Taxpayers are

"excluded corporations," G.S. 105-130.4(r) requires that their business income be apportioned by multiplying the income by the sales factor as determined under G.S. 105-130.4(l). If the Taxpayers are not excluded corporations, a different method of apportionment applies under G.S. 105-130.4(i) based on property, payroll, and sales. The relevant portion of G.S. 105-130.4(a)(4) defines an "excluded corporation" as "a corporation which receives more than fifty percent (50%) of its ordinary gross income from investments in and/or dealing in intangible property."

The Taxpayers contend that the phrase "investments in" intangibles as used in the statute does not include Taxpayers' activities of protecting, managing, and maintaining trademarks. The Taxpayers further contend that because they do not buy and sell their intangible property for the purpose of gain in the market, they do not "deal" in intangible property. They argue that their activities are not the same as "investments in and/or dealing in" intangibles, and they cite an Opinion of the North Carolina Attorney General, [1954 -1994 Transfer Binder] N.C. St. Tax Rep. (CCH) par. 201-528 (Aug. 18,1976), in support of that position.

According to Taxpayers, the Attorney General's opinion states that an entity will not be deemed to be dealing in intangible property unless it engages in "buying and selling [intangible property] for the purpose of gain in the market." *Id.* Their argument continues that because they did not buy and sell the trademarks for the purpose of gain in the market, they did not "deal in" intangible property and cannot therefore be considered "excluded corporations." (Taxpayers' Post-Hearing Answer Brief at 31).

The Department responds that Taxpayers have investments in intangible property and that Taxpayers deal in intangible property. According to the Department,

an entity makes an investment in property when it acquires the property for the purpose of making a profit. The Department therefore maintains that Taxpayers' acquisition of the marks and goodwill constituted an investment by Taxpayers in intangible property.

Although the Taxpayers insist that they are engaged in the business of owning, managing, and protecting the trademarks they acquired, it is only logical that they must have also acquired these intangible assets to generate a profit. In fact, the acquisition of the trademarks and their subsequent licensing to the related retail companies did result in significant profits to the Taxpayers. It is reasonable to assume that when a corporation obtains an asset, it is doing so as an investment with the ultimate purpose of increasing profits by generating revenues or reducing expenses.

The Department argues that the ordinary meaning of the phrase "dealing in" is broader than simply "buying and selling" and includes licensing. The Department asserts that Taxpayers' activities in acquiring their intangible property and subsequently licensing the property to their related retail companies in exchange for royalty payments constitutes dealing in intangible property.

I agree with the Department's position. In my opinion, the Taxpayers both "invest" and "deal" in the trademarks, which are intangible property. The Taxpayers received more than 50% of their ordinary gross income from their investments in or dealing in the trademarks. They therefore meet the statutory definition of "excluded corporation" set forth in G.S. 105-130.4(a)(4).

Because the Taxpayers are "excluded corporations," G.S. 105-130.4(r) specifically requires that they apportion their business income using the sales factor as determined under G.S. 105-130.4 (l). The Taxpayers argue that the single-factor sales

formula based upon the sales receipts of the related retail companies does not account for those trademark management and protection activities of the Taxpayers that occur outside of North Carolina. (Taxpayers' Post-Hearing Brief at 67). Therefore, the argument continues, an unfair apportionment of tax results because the "state has applied a method, which . . . operates so as to reach profits which are in no just sense attributable to transactions that occurred in North Carolina." *Hans Ress' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123,134 (1931).

The Department responds, correctly in my opinion, that the royalty income earned by the Taxpayers arises directly from the use of the trademarks in North Carolina by the related retail companies pursuant to the licensing agreements. While some trademark management activities may have occurred outside of this State, it was the use of the trademarks by the North Carolina retailers that generated the retail sales of apparel bearing these trademarks and resulted in the royalty income to Taxpayers. Thus, the principal income-producing activity of the Taxpayers consisted of their licensing of the trademarks and the resulting royalty income from the use of the trademarks in this State and in other states. The apportionment of the royalty income based upon the relationship of gross retail sales from North Carolina retail locations that were licensed to use Taxpayers' intangible property to gross retail sales of all locations licensed to use Taxpayers' intangible property is an equitable and meaningful method of computing the taxable income of the Taxpayers.

G.S. 105-130.4(t)(4) precludes the use by the Taxpayers of any alternative formula to the sales factor without a written order from the Tax Review Board. As there is no such order, the Taxpayers are required to use the prescribed sales factor. G.S.

105-130.4(l)(3) provides that sales occur in this state if "[t]he receipts are from intangible property and are received from sources with this State." Furthermore, "[t]here shall be a presumption that the appropriate allocation formula reasonably attributes to this State the portion of the corporation's income earned in this State, and the burden shall rest upon the corporation to show the contrary." G.S. 105-130.4(t)(4). The appropriate forum for the relief sought by the Taxpayers is the Tax Review Board. The Taxpayers have not sought this relief. Therefore, the Taxpayers must use the single-factor sales formula prescribed in G.S. 105-130.4(r) to apportion their business income.

V. CONSTITUTIONAL ISSUES

Both sides have spent considerable time developing excellent, detailed, and exhaustive constitutional analyses in support of their respective positions regarding the issue of whether the Taxpayers have taxable nexus with North Carolina. Although it is well settled that the Secretary cannot rule on the constitutionality of a statute, the matter certainly warrants comment. *Great American Insurance Company v. Gold*, 254 N.C. 168 (1961). Predictably, the arguments center around the differing interpretations of the United States Supreme Court decisions in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), as well as the sometimes celebrated, sometimes criticized decision by the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13, *cert. denied*, 510 U.S. 992 (1993).

A. Due Process

It has been established that the nexus requirements of the Due Process Clause and Commerce Clause of the U.S. Constitution are separate and distinct. *Quill*, 504

U.S. at 305-06, 312. The Department argues that the Taxpayers operate a business activity in North Carolina for economic gain because they extensively use their intangible property in this State through licensing agreements with their related retail companies, the related retail companies perform activities in this State on Taxpayers' behalf that are attributed to Taxpayers, and Taxpayers exercise actual control in fact over the use of the marks by the related retail companies in this State. The Department asserts that this business activity creates sufficient nexus with this State to permit the assessment of corporate income and franchise tax against the Taxpayers under the Due Process Clause of the U.S. Constitution.

The two requirements that must be met to satisfy the Due Process Clause are: (1) some minimal connection between the interstate activities and the state seeking to impose the tax; and (2) some rational relationship between the income the state is attempting to tax and the intrastate values of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-437 (1980). Although Taxpayers may have a physical presence in this State, a physical presence is not needed to satisfy the Due Process Clause. If a foreign corporation purposefully derives an economic benefit from a state, then it may be subjected to the jurisdiction of that state without having a physical presence there. *Quill*, 504 U.S. at 307.

The Department asserts that the Taxpayers purposefully derive an economic benefit from North Carolina through the licensing agreements between them and their related retail companies. The Taxpayers controlled the decision whether, to whom, and where they would license their marks. They purposefully chose to license their marks to 130 North Carolina retail locations. The Department cites these facts along with others

as evidence of Taxpayers' intent to participate in the North Carolina marketplace. (Department's Initial Brief at 19). The Department contends that Taxpayers' activities and those of the related retail companies acting on Taxpayers' behalf under the licensing agreements clearly meet the minimum contact requirements of the Due Process Clause.

The Department cites *Geoffrey* and *In the Matter of Kmart Properties, Inc.* CCH ¶ 400-976, New Mexico Revenue and Taxation Department, No. 00-04 (Feb. 1, 2000), as support for its contention that the Taxpayers purposefully availed themselves of the economic marketplace in North Carolina, noting that Taxpayers earned significant royalty income from garment sales generated by the North Carolina retail locations of the related retail companies. In *Kmart*, the court held that the trademark holding company subsidiary, which had no employees and no tangible or real property in New Mexico, had sufficient minimum contacts because it purposefully availed itself of the benefits of New Mexico's economic market by licensing highly valuable intangible property for use in New Mexico retail stores in return for royalty income.

The Taxpayers respond that the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954). They argue that there is no definite link or minimum connection between any of Taxpayers and North Carolina and that none of the Taxpayers purposefully directed any of their activities toward <u>residents</u> of this State as required to establish nexus for purposes of the Due Process Clause under *Quill*. Therefore, the Taxpayers conclude,

the assessments violate the Due Process Clause. (Taxpayer's Post-Hearing Brief at 41 n.14).

The distinction that the Taxpayers attempt to make between marketing activities directed at the residents of a state as opposed to the market of a state in an attempt to show that the assessments violate the Due Process Clause is not valid. It does appear from the record that the Taxpayers purposefully directed their business activities toward the North Carolina market as well as the residents of this State and derived an economic benefit from those activities that is sufficient to satisfy the minimum contact standards of the Due Process Clause. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

B. Commerce Clause

The Taxpayers also argue that the Department's attempt to subject the Taxpayers to North Carolina corporate income and franchise tax is not permissible under the Commerce Clause of the U.S. Constitution. Their argument is primarily based upon the contention that they do not have a physical presence in North Carolina and therefore cannot be taxable in this State. The Taxpayers insist that in *Quill*, the Supreme Court refined the four-part test set forth in *Complete Auto* to require a physical presence as a minimum criteria to satisfy the substantial nexus portion of the test. Taxpayers further argue that the Department's assessments violate all four parts of that test. (Taxpayers' Post Hearing Brief at 40-58).

According to the Taxpayers' argument, the Taxpayers have no physical presence in this State. The Taxpayers' argument continues that, because the U.S. Supreme Court in *Quill* held that an out-of-state retailer with no physical presence in the state

could not be required to collect use tax on its sales to in-state customers, the Taxpayers cannot be required to pay corporate income and franchise tax here. The Taxpayers argue that the physical presence requirement articulated in *Quill* for establishing substantial nexus is not limited to sales and use taxes but is also applicable to North Carolina's corporate income and franchise tax. (Taxpayers' Post-Hearing Brief at 43).

The Department responds that the Taxpayers are doing business in North Carolina as defined in Administrative Rule 17 NCAC 5C. 0102 for the reasons previously stated. The Department takes the position that the assessments do not violate the Commerce Clause for two primary reasons. First, the test under the Commerce Clause is substantial nexus rather than physical presence and Taxpayers have substantial nexus with North Carolina. Second, even if physical presence were required, the activities of the related retail companies performed in North Carolina on the Taxpayers' behalf pursuant to the companies' contractual agency relationship with the Taxpayers, as well as other factors, satisfy the physical presence requirement. The Department further contends that the assessments in this case do not run afoul of *Complete Auto's* other three requirements.

Under the *Complete Auto* four-prong test, a tax satisfies the Commerce Clause if it meets all of the following criteria:

(1) It is applied to an activity with a substantial nexus with the taxing state.

(2) It is fairly apportioned.

(3) It does not discriminate against interstate commerce.

(4) It is fairly related to the benefits and services provided by the state.

The Department's interpretation of *Quill* is understandably different from that of Taxpayers' counsel in that it states that substantial nexus, not physical presence, is required to meet the requirements of the Commerce Clause. The Department argues that the Supreme Court in *Quill* reaffirmed the physical presence requirement established in *Bellas Hess* for sales and use taxes, but did not extend the requirement to corporate income taxes. According to the Department, the Taxpayers have substantial nexus with North Carolina because they extensively use their intangible property in this State through licensing agreements with their related retail companies, the related retail companies perform activities in this State on Taxpayers' behalf that are attributed to and inure to the benefit of Taxpayers, and Taxpayers exercise actual control in fact over the use of the marks by the related retail companies in this State.

The Department points to the following in support of its contention:

(1) The Taxpayers' trademark licensing activities.

(2) The Taxpayers' purposeful availment of the marketplace here.

(3) The business situs of the Taxpayers' trademarks in this State.

(4) The representatives of the Taxpayers that perform services in this State on Taxpayers' behalf. (Department's Initial Brief at 21).

For these reasons, concludes the Department, the substantial nexus prong of the *Complete Auto* test and the requirements of the Commerce Clause are satisfied and Taxpayers have taxable nexus here. (Department's Initial Brief at 21-22).

In support of its argument that the Taxpayers' trademark licensing activities in North Carolina are sufficient to meet the substantial nexus requirement, the Department cites the holding of the Supreme Court of South Carolina in *Geoffrey*. (Department's

Initial Brief at 22). That case also involved a trademark protection company domiciled in Delaware that licensed the use of a trademark to an affiliated retailer located in South Carolina. The court held that the licensing of intangibles and the deriving of income from their use by an out-of-state corporation created substantial nexus with South Carolina.

The Department also cites the decision of *Kmart Properties, Inc*. That case also involved the formation of a separate trademark holding company to own and license trademarks and tradenames to an affiliated retail company, the original owner of the trademarks, for use in the retail operations in the exact same manner in which they had been previously used. *Kmart* held that a wholly-owned subsidiary that licensed trademarks to an affiliated operating store had substantial nexus with the state sufficient to satisfy the Commerce Clause.

In *Kmart*, the court held that the license agreement, which required the parent corporation to establish, maintain, and enhance the market for the subsidiary's trademarks in New Mexico, created a contractual agency relationship between the parties that provided the substantial nexus needed between the in-state parent company and the out-of-state subsidiary under the Commerce Clause of the U.S. Constitution.

The Department also argues that the Taxpayers have substantial nexus with North Carolina because their trademarks have a business situs here. (Department's Initial Brief at 28-31). The Department states that the use of the trademarks by the Taxpayers in furtherance of their licensing activities in this State gives the trademarks a business situs in North Carolina. Citing the requirements of trademark law and the

Lanham Act that a mark must be used in connection with an existing business in order to prevent its abandonment, the Department avers that the Taxpayers must be considered as having used the trademarks here because the usage in North Carolina by the related retail companies inures to the benefit of the Taxpayers and therefore protects and preserves the value and existence of the marks. The Department states that "[u]se of the trademark occurs every time a garment is sold to a North Carolina consumer." (Department's Post Hearing Brief at 16).

The Department contends that the fact that the Taxpayers have no employees or offices in North Carolina is not fatal to its assessments of corporate income and franchise tax because business activities were performed here by the related retail companies on behalf of the Taxpayers in furtherance of the companies' attempts to generate income here. *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987). The Department argues that the quality assurance and other activities performed by the employees of the related retail companies as required by the trademark licensing agreements and necessary for the protection of the marks should be attributed to the Taxpayers because these activities are necessary to preserve the existence of Taxpayers' marks, the activities are performed to fulfill Taxpayers' obligations under trademark law, and the activities helped maintain Taxpayers' market in North Carolina. Therefore, under the analysis in *Tyler Pipe*, substantial nexus exists between the Taxpayers and this State.

The Department also cites *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), in support of its argument that the trademark quality control measures and other activities performed by the employees of the related retail companies should be construed as

being done by Taxpayers. In *Scripto*, taxable nexus was established when an out-of-state retailer engaged independent contractors to conduct activities on its behalf within the taxing state. According to the Department, the quality control activities were required for the protection of the trademarks and to enhance the North Carolina market for the Taxpayers, allowing them to generate significant royalty income arising from the retail sales here. Because these activities were performed in North Carolina by the related retail companies' employees under their contractual agency relationship with the Taxpayers, the activities should be attributed to the Taxpayers. It is "these trademark protection activities performed in this State that create the substantial nexus [and] that justify subjecting the Taxpayers to tax." (Department's Initial Brief at 35).

The Taxpayers respond that the contractual relationship that existed between Taxpayers and the related retail companies in North Carolina is not enough to meet the substantial nexus standard. They argue that the activities of the related retail companies' employees, although performed to comply with the required terms of the trademark licensing agreements, should not be attributed to the Taxpayers. The Taxpayers contend that the employees of the related retail companies were neither independent contractors nor agents for the Taxpayers when they performed the activities and these activities did not directly establish a market for in-state sales by the Taxpayers, which distinguishes them from the taxpayers in both *Tyler Pipe* and *Scripto*. (Taxpayers' Post-Hearing Answer Brief at 28). The Taxpayers argued that since they have no employees, the activities of the employees of its in-state affiliates cannot be attributed to them.

The *Scripto* Court has already rejected the Taxpayers' argument by ruling that the distinctions between independent contractors and employees are without constitutional significance. It is of no consequence whether the activities are performed by a taxpayer's own employees (of which the Taxpayers had none in this case) or by others acting on the taxpayer's behalf. Here, the activities performed by the employees of the related retail companies are properly attributable to the Taxpayers.

Professor Richard Pomp [confirms] this fundamental principle:

> Of course, employees are only one category of individuals operating on behalf of a corporation who can provide the corporation with physical presence in the state. The in-state actions of agents and independent contractors can also confer nexus. While the relevant case law does not establish all of the relevant boundary lines, it is clear that an independent contractor does not have to work exclusively for the out-of-state corporation to confer nexus.

Richard D. Pomp and Oliver Oldman, State & Local Taxation, Vol. II, 9-94 (3rd. ed. 1998), (citing *Scripto*, 362 U.S. 207). (See also T3 p. 156).

In addition to the legal arguments arising from their interpretation of the nexus requirements of *Quill*, the Taxpayers presented testimony and various exhibits containing detailed economic analyses from several experts in the field of economics who opined why physical presence should be a required element of taxable nexus for North Carolina state taxation purposes under broadly accepted concepts of economic theory. Although the reports and testimony of the various expert witnesses offered by the Taxpayers may or may not have been admissible under the North Carolina Rules of Evidence, *see* G.S. § 8C - 1, Rules 701, 702, and 704, or otherwise competent, the rules of evidence do not apply at an administrative hearing before the Secretary. According to Taxpayers' expert witnesses in economics, the reasons why physical

presence should determine taxable nexus for North Carolina state tax purposes include: (1) preventing the improper exportation of tax burden; (2) ensuring proper matching of the cost of a state's benefits to the users of the state's services; and (3) preventing confusion in compliance. (Taxpayers' Post-Hearing Brief at 49-51).

The Taxpayers also cite many tax policy reasons for utilizing a bright-line rule in establishing a nexus standard for Commerce Clause analysis and why a physical presence test is so advantageous for that purpose. (Taxpayers' Post-Hearing Brief at 52-55). The Taxpayers' [expert witness in tax policy] testified that the use of the physical presence test prevents ambiguity, avoids the risk of multiple taxation, allows settled expectations, helps maintain parity in the taxation of service companies with other industries and avoids practical complications in the administration of a tax.

In Secretary's Final Decision 98-299, I stated that a physical presence is not required to establish taxable nexus for purposes of imposing corporate income taxes, although the taxpayer in that case did have a physical presence in North Carolina through its ownership of tangible personal property here. The Taxpayers understandably disagree with that decision. However, I continue to believe, in spite of the reasons given by the Taxpayers' expert witnesses discussed above, that the evolution of present day commerce requires a more flexible, modern rule that balances the proper jurisdiction of states to tax against the legitimate concerns of imposing inappropriate barriers to interstate commerce. (Taxpayers' Letter to the Assistant Secretary dated April 12, 2000, at 9 n.2).

Indeed, the landscape of commerce has changed significantly just since the inception of this case with the exploding popularity of the use of the internet in business

transactions and the attendant problems of developing a proper standard to apply in determining jurisdiction to tax these transactions. While the use of the physical presence standard may very well appeal to Taxpayers' expert witnesses, I still believe there is another, better test for determining substantial nexus that recognizes the realities and necessities of today's business climate as well as the various states' fiscal requirements. "The physical presence rule of State taxing jurisdiction is as obsolete as the horse and buggy as we near the twenty-first century's electronic era." Hellerstein and Hellerstein, State Taxation, par. 6.09, 6-22 (2d ed. 1993) The fact is, we are already there.

VI. COMBINED REPORTING

The Department asserts that, as an alternative to filing separate returns, the Taxpayers could be required to file a combined return with the appropriate related retail companies because the returns of the related retail companies do not disclose the true earnings of the companies from their business in this State. According to the Department, this failure is attributable to essentially arbitrary, intercompany transactions.

G.S. 105-130.6 permits the Secretary of Revenue to require a corporation to file a consolidated tax return with its subsidiaries and affiliates if she finds that the return filed "does not disclose the true earnings of the corporation on its business carried on in this State." In addition, G.S. 105-130.16 states, in relevant part, that:

> [w]hen the Secretary has reason to believe that any corporation so conducts its trade or business in such manner as to either directly or indirectly distort its true net income and the net income properly attributable to the State … the Secretary may require any facts as the Secretary considers necessary for the proper computation of the entire net income and the net income properly attributable to the State.

It is the Department's contention that the "Taxpayers were involved in an elaborate series of accounting mechanisms designed to shift income among related parties for the purpose of avoiding state income taxes." (Department's Initial Brief at 44).

The Taxpayers respond that because the royalty rate they charged to the related retail companies was considered "arms length" under the standard set forth in I.R.C. § 482 according to [their expert witness], then no distortion of income occurred and the requirement of a combined report would be inappropriate. (Taxpayers' Post-Hearing Answer Brief at 30). They insist that the Taxpayers served significant business purposes and the royalty fees incurred by the related retail companies were legitimate deductions.

However, regarding the intercompany agreements between the Taxpayers and the related retail companies, [the] Taxpayers' expert witness, testified that "[w]hen you deal with a transaction between a related party, the transaction itself is not at arm's length. It cannot be - it could not have come about by an arm's length negotiation." (T. 5/11/98 pp. 68-69). [The expert witness] also stated that "[t]he [intercompany] agreement should never have been described as an arm's length agreement, because it couldn't have been." (T. 5/11/98 p. 70).

[The Taxpayers' expert witness] further testified that the Internal Revenue Service would have had no "motivation" to make an I.R.C. § 482 adjustment to the intercompany transactions because they were completely eliminated in a consolidated federal income tax filing. (T. 5/11/98 p. 92). [He] described I.R.C. § 482 as "the Internal Revenue Code section which gives the Secretary of Treasury the power to adjust

transactions that occur between related parties so as to properly reflect income." (T. 5/11/98 p. 41).

The Department takes the position that the related retail companies, by transferring their trademarks to Taxpayers for little or no consideration, then licensing the trademarks they formerly owned back from the Taxpayers, who then recorded the payment of the required royalty fees in accounts receivable and never converted them into cash, shifted millions of dollars of income to Delaware that would normally have been taxable in North Carolina. According to the Department, the royalty fee expenses were merely paper transactions that improperly reduced the North Carolina taxable income of the related retail companies. (Department's Initial Brief at 47).

I agree that the manner in which the Taxpayers conducted their transactions with the related retail companies results in the failure of the related retail companies to accurately disclose their true taxable income from business activities conducted in North Carolina. As an example of the improper reflection or distortion of income that occurred, the Department notes, for example, that [Taxpayer, Subsidiary Trademark Company One's] total expenses for the three years at issue were $729,175 compared to total accrued income of $311,952,574 during the same period. (Exhibit 72). Of [these] total expenses, legal expenses alone equaled $687,754 or 94.32% of total expenses. The remaining expenses, such as general, administrative, and other operating expenses, were immaterial and reflect that no substantive operations were actually conducted within the company. (Department's Initial Brief at 10-11).

During the same period, [the Parent Company, which was the Related Retail Company for Taxpayer, Subsidiary Trademark Company One,] reduced its North

Carolina apportionable income by millions of dollars in royalty fees - royalty fees paid for the use of trademarks they previously owned and used without the need to pay for such use and which they transferred to [Taxpayer, Subsidiary Trademark Company One] for little or no consideration. The same corporate structure and series of transactions were used for all of the Taxpayers and their related retail companies. The Department's Exhibit 72 shows that during the audit period, the Taxpayers reported $1.2 billion in net income, while the related retail companies reported a net taxable loss of $203 million. But for the royalty fees incurred for the use of trademarks they had previously owned and gave away for little or no consideration, the related retail companies would have been profitable. In my judgment, requiring a combination of the Taxpayers' net income with that of their related retail companies would permit "the underlying substance of the business activities occurring in this State to take precedent over the superficial form of the transactions." (Department's Initial Brief at 47).

Although the Taxpayers insist that the trademarks originally owned and used by the related retail companies were transferred to them for legitimate business reasons other than tax avoidance, the fact remains that the profitability of the related retail companies decreased precipitously immediately subsequent to the trademark transfers. This was an adverse impact on the profitability of the related retail companies that was disproportionately larger than the alleged benefits from the transfers cited by the Taxpayers. Indeed, in view of the tremendous and ongoing negative effect on the net income of the related retail companies resulting from the trademark transfers, one is left to wonder whether a proper analysis of the financial and legal effects of the transactions took place and how the management of the companies could justify the original

transfers, let alone the continuation of such an unprofitable arrangement. In my judgment, the transactions entered into between the Taxpayers and their related retail companies arbitrarily shifted income between them, thereby improperly reflecting their true net income and providing a basis to require the filing of a combined return pursuant to G.S. 105-130.6 and 105-130.16.

The facts of this case support a combination of the Taxpayers and their related retail companies. The facts also support the assessment of Taxpayers for failing to file returns while doing business in this State. In similar cases, the Department could pursue a combination, a separate assessment, or both as alternatives.

VII. CONCLUSION

The cacophony of controversy arising from the widely divergent interpretations of similarly worded statutes and regulations in other states across the nation indicates that the issue of what constitutes substantial nexus is not settled. Indeed, this aspect of tax law has been the subject of many and different opinions in various writings from some of the country's foremost legal scholars and jurists.

Ultimately, many of the outstanding questions concerning when a corporation can be subject to tax in a state must be settled by the United States Supreme Court, which will hopefully address the matter soon. Until then, administrative decisions may only contribute to, rather than dispel, the thick legal mist that surrounds these issues.

While I do not agree with the finding in *Cerro Copper Products, Inc.,* 1995 Ala. Tax Lexis 211 (Ala. Dept. of Rev., Docket Number F-94-444, Dec. 11, 1995) that physical presence is required for nexus, I do concur with Judge Thompson's statement in that case that the holding in *Geoffrey* may have resulted from the South Carolina

Supreme Court's concern "that an out-of-state corporation can economically exploit and profit from a state's citizens, yet cannot be required by the state to pay its fair share of tax." *Id.* at 8. There are clearly some significant and justifiable tax policy reasons to impose corporate income and franchise taxes upon the out-of-state subsidiaries or affiliates of North Carolina companies that license back trademarks acquired in tax-free stock exchanges from those companies with the result that millions of dollars of income are excluded from taxation in this State through various corporate gyrations. *See, e.g.,* I.R.C. § 369(d).

Despite any policy reasons for or against imposing a tax in various circumstances, a Secretary's decision must be based on the applicable law. Under North Carolina's statutes and rules, the Taxpayers are doing business in this State and are excluded corporations.

Therefore, the proposed assessments of corporate income and franchise tax for the fiscal year ended January 31, 1994, as modified herein, are correct under the law and the facts, are sustained, and are immediately due and collectible together with interest as required by law.

This the __19th__ day of __September__, 2000.

Signature________________________________

Michael A. Hannah
Assistant Secretary of Revenue