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Subject:

New York State Court of Appeals Will Not Review *Sherwin-Williams*

State Tax Alert

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Date/Timing:

The New York Court of Appeals will not review the Sherwin-Williams Co. decision, in which the New York State Supreme Court, Appellate Division, upheld a Tax Appeals Tribunal decision requiring Sherwin-Williams to file a combined New York corporate franchise tax report with its trademark subsidiaries.

Details:

In *The Petition of The Sherwin-Williams Co., New York Division of Tax Appeals*, Administrative Law Judge Unit, DTA No. 816712 (June 7, 2001), the ALJ had concluded that the assignments of the trademarks to Sherwin-Williams Investment Management Co. Inc. (SWIMC) and Dupli-Color Investment Management Co. Inc. (DIMC) were:

- Accomplished for a valid business purpose;
- That the royalty rates charged on the license-back of those trademarks were appropriate and at arm's length;
- That the rates charged for trademark services by Sherwin-Williams were at arm's length; and
- That the interest rate charged by SWIMC on its loan to Sherwin-Williams was at arm's length.

On the basis of these findings, the ALJ concluded that Sherwin-Williams had rebutted the presumption of distortion established under New York's combined reporting rules and could not be required to file a combined report with SWIMC and DIMC for 1991.

In June, 2003, the New York State Tax Appeals Tribunal overturned the previous ALJ decision regarding *In Matter of The Sherwin-Williams Company* (Decision DTA No. 816712, June 5, 2003). Upon review of the lengthy record (including a 3,700-page transcript), the Tax Appeals Tribunal concluded that the ALJ had erred in finding certain facts based

on that record. It found, contrary to the ALJ, that the transactions in issue were inherently illogical and had no valid business purpose other than tax avoidance. In addition, the tribunal concluded that the transactions had no economic substance because the objectives of the business plan that accompanied the creation of SWIMC and DIMC were unattainable, were not pursued, and offered no economic benefit.

The Tax Appeals Tribunal ruled that Sherwin-Williams must file on a combined basis with its two Delaware trademark protection subsidiaries for state corporation franchise tax purposes.

Following the Tax Appeals Tribunal decision, the New York Supreme Court, Appellate Division, Third Department upheld the decision of the State Tax Appeals Tribunal sustaining a determination of the Department of Taxation and Finance requiring Sherwin-Williams to file a combined corporate franchise tax report with two of its subsidiaries for 1991 (*Sherwin-Williams Co. v. Tax Appeals Tribunal*, Oct. 28, 2004).

Under Article 9-A of the Tax Law, the Tax Department has discretion to permit or require a corporation to file a combined report with other corporations that the taxpayer controls. Requirements that must support a decision permitting or mandating a combined report are: (1) the taxpayer owns or controls substantially all the stock of the other corporations; (2) the group of corporations is engaged in a unitary business; and (3) a distortion of income would result if the corporations reported separately. The company did not contest that the first two conditions, however, contested the third. The court held that a presumption of distortion arises if there are substantial intercorporate transactions among the corporations. The tribunal found that Sherwin-Williams had substantial intercorporate transactions with its subsidiaries and that the presumption of distortion therefore applied and forced combination of the entities.

Now that the decision in *Sherwin-Williams* will no longer be appealed, it heightens the attention given at the state level regarding common trademark protection company structures, and reveals the various views that have been taken even within the same state. The decision of the New York Court of Appeals to not review *Sherwin-Williams* and the enactment of anti-Passive Investment Company legislation on May 15, 2003, requires companies currently utilizing a Passive Investment Company or similar "Holding Company" structure to review this antiquated planning technique.

BDO Seidman can facilitate the replacement of your current Delaware Holding Company with state tax reducing strategies to fit naturally around your business operations. Examples of BDO Seidman's most popular state tax reducing strategies include:

- 197 Strategy,
- Embedded Royalty Company, and
- Effective Use of Transfer Pricing.

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