These are appeals filed under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39, from the refusal of the Commissioner of Revenue ("Commissioner" or "appellee") to abate corporate excise, interest and penalties assessed to the appellants, IDC Research, Inc. f/k/a International Data Corporation ("IDC"), World Expo Corporation ("World Expo"), and CW Publishing Corporation ("CW Publishing") (collectively "appellants") under G.L. c. 63, § 32 for the tax years ended September 30, 1992, September 30, 1993 and September 30, 1994 ("years at issue").¹

Commissioner Scharaffa heard the appeals and was joined by Commissioners Egan, Rose and Mulhern in the decisions for appellant IDC in Docket No. C267868 and

¹ Appellant World Expo Corporation’s appeal involved only the tax years ended September 30, 1992 and September 30, 1993 ("World Expo years at issue").
appellant CW Publishing in Docket No. C271245, and in the
decision for the appellee in Docket No. C268725. Chairman
Hammond took no part in the deliberations or decisions of
these appeals.

These findings of fact and report are made pursuant to
requests by the appellants and the appellee under
G.L. c. 58A, § 13 and 831 CMR 1.32.

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for the appellee.

**FINDINGS OF FACT AND REPORT**

I. Introduction

These appeals present multiple issues, both
substantive and procedural, for the Appellate Tax Board’s
(“Board”) determination. The issues concerning only IDC
are whether the Commissioner properly adjusted the income
of its parent corporation, International Data Group
(“IDG”), to reflect fair compensation for services provided
by IDG to its domestic subsidiaries and whether royalty
income received by one of IDG’s subsidiaries, IDG Holdings,
Inc. (“Holdings”) for the licensing of a certain trademark,
known as the World Logo ("World Logo") was properly reallocated by the Commissioner to IDG.

The issues concerning only CW Publishing are whether the Commissioner abated the assessments against CW Publishing for the years at issue and whether CW Publishing timely filed its Petition with the Board.

The issue raised by all three appellants is whether the Commissioner properly adjusted the sales factor of their apportionment formula for the purposes of calculating the appellants' corporate excise.²

II. Findings of Fact

On the basis of a Statement of Agreed Facts and the accompanying exhibits, and the testimony and exhibits offered into evidence at the hearing of these appeals, the Board made the following findings of fact.

A. The Appellants

Appellant IDC is a Massachusetts corporation with a principal place of business in Framingham. IDC is a wholly-owned subsidiary of IDG, a Massachusetts corporation which is majority owned by its founder and Chairman,

² Though the Commissioner made adjustments to the sales factor of many of IDG’s subsidiaries during the audit, those adjustments resulted in de minimis increases in corporate excise, if any, with the exception of CW Publishing. Although each of the appellants had raised the issue in their Petitions, at the hearing and in the post-hearing briefs, the parties limited their discussion of this issue to CW Publishing.
Patrick McGovern. IDG and IDC were part of a combined reporting group for the years at issue, for which IDC was the principal reporting corporation. Appellants World Expo and CW Publishing are, like IDC, Massachusetts corporations and wholly-owned subsidiaries of IDG and were also part of the combined reporting group for the years at issue. Appellant CW Publishing was the publisher of the weekly newspaper Computerworld ("Computerworld")\(^3\) during the years at issue and is now known as Computerworld, Inc.

**B. The Witnesses**

Eighteen witnesses testified at the hearing of these appeals, including four expert witnesses. The appellants called the following witnesses to support their abatement claims: (1) Patrick McGovern, the founder and Chairman of IDG; (2) William Murphy, the former Vice President of Finance, Executive Vice President of Finance, Chief Financial Officer ("CFO") and Treasurer of IDG; (3) Wilson Walter Boyd ("Walter Boyd"), the former Chief Operating Officer ("COO") and President of IDG; (4) James T. Hourihan, an auditor for the Massachusetts Department of Revenue ("DOR"); (5) Edward Bloom, the CFO and Treasurer of IDG; (6) Jayne Enos, the Vice President of Tax of IDG; (7)

\(^3\) During the course of the hearing, many witnesses used the terms CW Publishing and Computerworld interchangeably. For ease of reference and clarity, the Board will hereinafter refer to the corporation as CW Publishing and the publication as Computerworld.
John Sheilds, a tax examiner for DOR; (8) Richard Holland, an employee of DOR’s Collections Bureau; (9) Richard Ciliberto, the Facilities Director for CW Publishing; (10) George M. Locarno, Esq.; (11) Kirk Campbell, the President and CEO of IDC; (12) Patrick Kenealy, the former President, Publisher and CEO of PC World Communications, Inc., (“PC World”) an IDG subsidiary; (13) Ethan Horwitz, Esq., who testified as an expert in international trademark law; (14) Mark Sullivan, the CFO of IDC and the former Controller of CW Publishing; (15) Matthew Smith, the Executive Vice President and COO of CW Publishing; and (16) Irving Plotkin, Ph.D., who testified as an expert in microeconomics with a special expertise in transfer pricing and valuations.

The Commissioner called two witnesses to support her position: (1) Lee Carl Bromberg, Esq., who testified as an expert on trademark law management and practice; and (2) Jill Weise, who testified as an expert in the field of transfer pricing.

C. Jurisdiction and Procedural Issues

1. Jurisdiction: IDC and World Expo

IDC timely filed its corporate excise returns for each of the years at issue. World Expo timely filed corporate excise returns as part of IDC’s combined group and also
timely filed separate corporate excise returns reporting
the non-income measure of the excise for each of the World
Expo years at issue. On April 4, 1995, the Commissioner
commenced an audit of IDC and its affiliates. During the
course of the audit, sixteen separate Consents Extending
the Time for Assessment of Taxes ("Consents") were executed
by the Commissioner and the appellants. Through the
Consents, the time for the Commissioner to make additional
assessments of corporate excise was extended to ninety days
after a Letter of Determination was issued by DOR's Office
of Appeals. A Letter of Determination was issued to all of
the appellants on January 22, 2003, which extended the time
for the assessment of taxes until April 22, 2003.

Following the audit, the Commissioner issued to IDC a

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4 In their post-hearing brief, the appellants raised for the first time
the argument that the Commissioner's assessments were invalid as they
were not made within the time limits set forth by G.L. c. 62C, § 26
because they were made nearly six years after the filing of the return
for the last year at issue in these appeals. The Board allowed the
Commissioner's post-hearing motion to enter the Consents into evidence
in these appeals. Therefore, the evidence of record established that
the assessments were validly and timely made pursuant to G.L. c. 62C,
§ 26 and G.L. c. 62C, § 27, and the appellants' argument was without
merit. Further, the Board noted that the appellants' argument was made
in bad faith, as the appellants had knowledge of the fact that the
Consents had been executed. In making this argument, the appellants
did not contend that the Consents had not been executed; rather, they
simply argued that they had not been entered into evidence. Because
the Consents had been executed by both the Commissioner and the
appellants, they were presumably within the possession of the
appellants, yet the appellants did not enter them into the record.
Moreover, although Jayne Enos, who signed the Consents on behalf of the
appellants, was called as a witness by the appellants at the hearing,
the appellants elicited no testimony concerning the Consents and failed
to raise the argument at any time prior to the filing of their post-
hearing brief, despite the fact that the hearing lasted thirteen days
and involved the testimony of eighteen witnesses.
Notice of Intention to Assess ("NIA") dated October 15, 2001, proposing additional assessments of corporate excise for the years at issue. The Commissioner issued to World Expo an NIA dated October 15, 2001, proposing additional assessments of corporate excise for each of the World Expo years at issue. By Notice of Assessment ("NOA") dated February 11, 2003, the Commissioner gave notice to IDC of the additional assessment of corporate excise in the amount of $870,318 for tax year 1992, $1,497,567 for tax year 1993, and $1,120,725 for tax year 1994, together with penalties and interest. By NOA dated February 11, 2003, the Commissioner gave notice to World Expo of the additional assessment of corporate excise in the amount of $2,675 for tax year 1993 and $516 for tax year 1994, together with penalties and interest.


IDC timely filed its Petition with the Board on May 21, 2003. World Expo timely filed its Petition with the Board on June 6, 2003. On the basis of these facts, the
Board found and ruled that it had jurisdiction to hear and decide the appeals for Docket Nos. C268725 and C267868.

2. Jurisdiction: CW Publishing


On March 12, 2003, John Shields, a DOR examiner, began reviewing CW Publishing’s abatement applications. Mr. Shields, who testified at the hearing of these appeals, stated that after reviewing CW Publishing’s abatement applications, he determined that the applications should be denied. On March 20, 2003, Mr. Shields entered notes relating to the abatement applications in the MIRROR

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5 CW Publishing timely filed corporate excise returns as part of IDC’s combined reporting group as well as by filing its own separate corporate excise returns reporting the non-income measure of the excise for each of the years at issue.

6 As discussed above in section C (1), the time for making of all of the assessments at issue was extended to April 22, 2003, via sixteen separate Consents executed by the Commissioner and the appellants. The assessments against CW Publishing were therefore timely pursuant to G.L. c. 62C, § 26 and G.L. c. 62C, § 27.
system, which is one of DOR’s computer systems. The MIRROR system works separately from, but in conjunction with, DOR’s other computer system, known as MASSTAX, to process and keep track of abatement applications, departmental notices and other actions and correspondence. MIRROR and MASSTAX both serve case-tracking roles, but MASSTAX can generate notices and perform other functions, while MIRROR is, in the words of Mr. Shields, an “electronic filing cabinet.”

Mr. Shields’ notes in the MIRROR system on March 20, 2003 indicated that CW Publishing’s abatement applications were “denied in full” and that its abatement applications, along with two related abatement applications, filed by “IDG Research [sic]... and World Expo... [a]ll will be denied on MASSTAX and submitted for review together.”

According to Mr. Shields, his delegation of authority within DOR extended only to abatement applications involving up to $25,000 in tax. Determinations on abatement applications requesting an abatement of tax greater than $25,000, such as CW Publishing’s abatement applications, required the approval of Mr. Shields’ supervisor, Alan Breen.

According to his testimony, Mr. Shields inadvertently entered the code for an abatement approval instead of an
abatement denial into the MASSTAX system. Mr. Shields testified that the entry of an abatement approval was a keystroke error on his part, and that he was unaware of the error at the time. This keystroke error was made on or about March 21, 2003.  

Mr. Shields testified that on Monday, March 24, 2003, Mr. Breen reviewed his recommendations as to CW Publishing’s abatement applications, and approved those recommendations by entering the appropriate code into the MIRROR system and into the MASSTAX system. Mr. Shields stated that, because he had entered the code for an abatement approval, Mr. Breen’s actions caused an abatement approval to be recorded in MASSTAX on March 24, 2003. Mr. Breen did not testify at the hearing of these appeals.

On March 25, 2003, a Notice of Abatement Approval ("NAA") was generated by the MASSTAX system and was automatically printed and mailed to CW Publishing, in an envelope postmarked March 28, 2003. The address listed on the NAA was 5 Speen Street in Natick. 5 Speen Street in Natick was the address of record listed in MASSTAX for CW Publishing, whereas the address listed on CW Publishing’s abatement applications was 500 Old Connecticut Path in

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7 Mr. Shields’ testimony as to the date of his keystroke error was inconsistent. He initially testified that he committed the error on March 24, 2003, then later stated that it occurred on March 21, 2003.
Framingham. 500 Old Connecticut Path in Framingham was CW Publishing’s office address, but tax matters for IDG’s subsidiaries were generally handled by Jayne Enos, who worked at IDG’s headquarters, located at 5 Speen Street in Natick. Ms. Enos testified at the hearing of these appeals, and the Board found her testimony to be credible. She testified that she received the NAA sometime shortly after March 25, 2003.

According to Mr. Shields’ testimony, while he was waiting for Mr. Breen to approve his recommendations, he had drafted an NOAD to issue to CW Publishing. Instead of using the MASSTAX system to create the NOAD, Mr. Shields created the NOAD on a Microsoft Word application on his own desktop computer. Mr. Shields testified that he often created NOADs on his own computer so that he could provide further detail to taxpayers about the reasons for an abatement denial because the MASSTAX system did not allow for extensive explanation to be entered on notices. However, the NOADs issued to CW Publishing contained no explanation of the reasons for the denial. Rather, they appeared to be form denial letters, which contained only the following generic explanation for the denial: “After review of your applications and other relevant materials, it is the conclusion of this Bureau that the Audit
adjustments at issue are correct.” No details or further explanation were contained on the NOAD.

Mr. Shields testified that, following Mr. Breen’s actions, he printed two copies of the NOAD, which was dated March 24, 2003, from his desktop computer. He also testified that, in hand-addressed envelopes, he sent one copy of the NOAD to the attention of Jayne Enos at CW Publishing, 500 Old Connecticut Path in Framingham and a second copy of the NOAD to CW Publishing’s Power of Attorney of record, George M. Locarno, Esq., at 400 Commonwealth Avenue in Boston, which were the addresses listed on the abatement application. Mr. Locarno also testified at the hearing of these appeals, and the Board found his testimony to be credible. Both Mr. Locarno and Ms. Enos, who had each signed the abatement applications, testified that they did not receive the NOAD.

According to Mr. Shields’ testimony, on Tuesday, March 25, 2003, DOR employee Richard Ray was reviewing recent abatement approvals, and questioned Mr. Shields, who was his supervisor, regarding CW Publishing’s abatement approval. Mr. Shields stated that it was Mr. Ray who alerted him for the first time about his keystroke error. According to Mr. Shields, Mr. Ray then entered an abatement denial code into the MASSTAX system. The evidence showed
that Mr. Ray entered a note in the MASSTAX system that he had “reprocessed the denial” on March 25, 2003, and an abatement denial was recorded in MASSTAX on March 26, 2003. Mr. Ray did not testify at the hearing of these appeals. According to his testimony, Mr. Shields believed that his error had been caught in time and was unaware that an NAA already had been issued to CW Publishing.

Another NOAD issued to CW Publishing for the years at issue was entered into evidence in these appeals. That NOAD was dated April 14, 2003 – the same date as an NOAD issued to World Expo – and contained the same information as the March 24, 2003 NOAD. Mr. Shields testified that he created the April 14, 2003 NOAD on his desktop computer, but could not remember why. He stated that, as he had previously done, he hand addressed two envelopes and mailed a copy of the NOAD to Ms. Enos at CW Publishing, 500 Old Connecticut Path in Framingham and Mr. Locarno at 400 Commonwealth Ave. in Boston. Again, Ms. Enos and Mr. Locarno testified that they did not receive the NOAD.

In early July of 2003, Richard Holland, an employee with DOR’s Collections Bureau, attempted to contact Jayne Enos about CW Publishing’s outstanding tax liability. Mr. Holland testified at the hearing of these appeals that he waited until July because it was customary to wait at
least 70 days from an abatement denial. He therefore waited 70 days from the later date, April 14, 2003. He further testified that he received a return phone call from Attorney William Halmkin, who informed Mr. Holland that he represented CW Publishing. Mr. Holland testified that it was clear to him from their conversation that CW Publishing believed the abatement applications had been approved, not denied.

Following their conversation on July 8, 2003, Mr. Holland faxed to Mr. Halmkin a copy of the NOAD dated March 24, 2003. Based on Mr. Halmkin’s receipt of the facsimile copy of the NOAD on July 8, 2003, CW Publishing filed its Petition with the Board on July 24, 2003. That Petition was signed by Mr. Halmkin, who likewise signed the Petitions for appellants IDC and World Expo.

On the basis of all of the evidence, the Board found that the Commissioner abated the assessments against CW Publishing on March 24, 2003. The Commissioner’s internal records, maintained in the MASSTAX system, reflected that the assessments were abated on that date. For each of the years at issue, the MASSTAX records showed that the deficiency assessments which were entered into MASSTAX on
February 10, 2003\textsuperscript{8} were subtracted from CW Publishing’s liability on March 24, 2003.

The Commissioner offered a lengthy version of events surrounding the reasons for the abatement approval and subsequent denial, primarily through the testimony of John Shields. However, the Board did not find the testimony of Mr. Shields to be credible for several reasons.

First, Mr. Shields’ testimony was inconsistent and based on his admittedly vague memory. Mr. Shields initially testified that he committed a keystroke error in MASSTAX on March 24, 2003, then later altered his testimony, stating that he committed the keystroke error on March 21, 2003. Mr. Shields even admitted that he had no direct recollection of some of the events about which he was testifying.

Second, Mr. Shields’ testimony was contradicted by the documentary evidence. Mr. Shields testified that he created NOADs on his desktop computer, rather than on MASSTAX, so that he could provide a detailed explanation as to the reasons for an abatement denial. However, the NOADs entered into evidence in CW Publishing’s appeal did not contain specific details or explanation of the reasons for

\textsuperscript{8} The date of assessment on the NOA was February 9, 2003.
the denial. Rather, they appeared to be form letter denials, which included only a brief, generic response.

Third, the Board found that Mr. Shields’ testimony lacked essential corroboration. Key elements of Mr. Shields’ testimony regarding the events surrounding CW Publishing’s abatement applications involved the actions of his supervisor, Alan Breen, as well as another DOR employee, Richard Ray. However, neither Mr. Breen nor Mr. Ray testified at the hearing of these appeals. Because the Board found Mr. Shields’ testimony to be less than credible, it gave little weight to his testimony.

Further, the Board found that there was considerable confusion in the record as to the dates and events surrounding CW Publishing’s abatement denials. Mr. Shields’ notes in the MIRROR system, entered on March 20, 2003, indicated that the abatement applications of all three of the appellants were to be denied in MASSTAX and would be “submitted for review together.” However, it was undisputed that IDC’s NOAD was dated March 24, 2003, while World Expo’s NOAD was dated April 14, 2003. At the same time, the Commissioner claims to have generated and mailed NOADs with both of those dates to CW Publishing, as well as an NAA dated March 25, 2003. There was no explanation in the record as to why three abatement applications which
were purportedly all to be denied and "submitted for review together" received such disparate treatment. The Board found that these inconsistencies in the record cast doubt upon the date of the Commissioner's actions relative to CW Publishing's abatement denials, as well as the probative value of the MIRROR records themselves, as they seemed to embody intentions which did not necessarily become realities.

Moreover, the confusion as to the sequence of events was compounded by Mr. Shields' failure to use the MASSTAX system to generate the NOADs. Mr. Shields testified that he created a NOAD dated March 24, 2003 on his desktop computer. However, because he used his desktop computer, nothing in the record proved that he took those actions on March 24, 2003, before the approval of the abatement in MASSTAX on March 24, 2003, as opposed to after being notified of his error by Richard Ray on March 25, 2003.\(^9\)

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\(^9\) Trial Exhibit A was entered into evidence by the Commissioner. It included documents printed from the MIRROR system, such as a scanned copy of CW Publishing's abatement application as well as notes entered by Mr. Shields in the MIRROR system. Exhibit A also included a copy of the NOAD dated March 24, 2003. The Commissioner argued in her post-hearing brief that Exhibit A proved that the NOAD was scanned into the system on March 24, 2003 because the MIRROR case was closed on March 24, 2003 and MIRROR files cannot be altered once a case is closed. However, nothing on the face of the documents indicated that the attached NOAD was part of the MIRROR file, rather than a NOAD printed separately and appended thereto. The Board found that Exhibit A did not establish that the NOAD was created on March 24, 2003.
In contrast, there was little confusion in the MASSTAX records as to the sequence of events surrounding the approval of CW Publishing’s abatement applications. The MASSTAX records reflected that CW Publishing’s abatement applications were approved on March 24, 2003, and that the tax amounts previously assessed were subtracted from CW Publishing’s tax liability. Consistent with that approval, an NAA dated March 25, 2003 was generated by the MASSTAX system, mailed in an envelope postmarked March 28, 2003, and received by CW Publishing shortly thereafter. The MASSTAX record entitled “Abatement Summary,” which was entered into evidence, left little doubt as to the sequence of events. That document showed only two entries: an abatement approval on March 24, 2003, and an abatement denial on March 26, 2003.

Accordingly, on the basis of all of the evidence, the Board found and ruled that the assessments against CW Publishing for the years at issue were abated on March 24, 2003. Further, the Board found and ruled that, following the Commissioner’s abatement of the amounts at issue, there were no valid assessments remaining against CW Publishing for the years at issue.

However, because the Commissioner maintained that those abatements had not been granted, the Board addressed
the timeliness and the merits of CW Publishing’s appeal. On the basis of all of the evidence, the Board found that CW Publishing did not receive an NOAD until July 8, 2003, when it received a faxed copy of an NOAD. Because CW Publishing filed its Petition just sixteen days later, on July 24, 2003, the Board found and ruled that CW Publishing timely filed its Petition and that the Board therefore had jurisdiction to hear and decide this appeal. Further, as discussed below in section F, the Board found that CW Publishing was entitled to the abatements at issue because the Commissioner’s adjustments to its sales factor were improper. Based on these findings, the Board decided this appeal for CW Publishing.

D. The Administrative Services Issue

1. IDG’s Corporate Organization and Operations

IDG was founded by Patrick McGovern in 1964 as a Massachusetts corporation. It quickly flourished into a large conglomerate with numerous subsidiaries, all of which were engaged in providing information about computer technology through trade shows, conferences, market research, and the publication of newspapers, magazines and books. At the time of the hearing of these appeals, IDG had in total 50 domestic subsidiaries and 62 foreign subsidiaries, which together published approximately 300
newspapers and magazines in 85 countries. IDG employed between three and four dozen individuals at its Massachusetts headquarters during the years at issue. IDG and its subsidiaries employed approximately 13,500 people worldwide.

Many of IDG’s current and former executives, including Patrick McGovern, Walter Boyd, William Murphy and Edward Bloom, testified at the hearing of these appeals about IDG’s corporate organization, mission and activities, and the Board found their testimony to be credible. Mr. McGovern explained that IDG functioned primarily as an entrepreneurial search engine, constantly looking for new opportunities in the information technology market. Mr. Bloom described Mr. McGovern as a “serial entrepreneur,” while Mr. Murphy stated that it was a bad year if IDG did not start two or three new companies.

Mr. McGovern and his staff dedicated a substantial portion of their efforts to researching new technologies and other areas of the market which could benefit from a publication or other service. Mr. McGovern testified that once a new opportunity was detected, IDG would incorporate a new subsidiary to focus on that particular market niche. He gave the following example: “I would determine that the mobile phones are now being turned into multi-media
computers and there would be a good opportunity for publications and training and information. Then I would go out and maybe set up a company in the U.S. dedicated on that.”

Mr. McGovern further explained that once IDG decided to establish a new subsidiary, IDG interviewed and hired a CEO for that subsidiary and worked with the subsidiary to establish one-year and three-year business plans. At least one IDG executive would serve as a member of the subsidiary’s board of directors and attend periodic board of directors’ meetings. After forming the corporation and hiring a CEO, IDG’s involvement in its subsidiaries’ activities was negligible. IDG viewed its subsidiaries as investments, and its subsidiaries viewed IDG as a bank. This outlook was consistent with IDG’s *modus operandi* of decentralization.

Mr. McGovern testified that in the early 1970s, IDG first embraced the concept of decentralization, under which operations were conducted through “independently organized, locally managed business units.” Thus, each subsidiary was left to run its day-to-day operations and make decisions independently. In his testimony, Mr. McGovern described the benefits of decentralization. First, he explained, each subsidiary was likely to be particularly knowledgeable
about the specific market in which it specialized and therefore better positioned than IDG to respond to the needs of that market. Second, if IDG remained uninvolved in the day-to-day operations and decisions of a subsidiary, it could not be blamed for a subsidiary’s failures; it was therefore easier to hold the CEO of each subsidiary accountable, according to Mr. McGovern.

IDG so valued the concept of decentralization that it appeared on IDG’s Corporate Values Plaque, one of which was entered into evidence in these appeals. According to the testimony of Patrick McGovern, the Corporate Values Plaque was hung in the lobby of IDG’s corporate office and in the lobbies of its subsidiaries. Over the years, business articles appearing in The Boston Globe and INC., Magazine have reported on IDG’s decentralized business model, and copies of those articles were entered into evidence in these appeals.

Despite its decentralized method of doing business, IDG provided certain services to its domestic subsidiaries, for which it charged a fee. IDG offered to all of its domestic subsidiaries accounting and credit services (“accounting services”), and to those engaged in publishing, IDG offered marketing and advertising services (“marketing services”). The fee rate for the accounting
services was typically 1.5% of the subsidiary’s annual revenue, while the fee rate for the marketing services was typically between 1% and 2.5% of the subsidiary’s annual revenue. Those rates, however, were negotiable, and subsidiaries were also free to engage other, independent providers for the services.

The hearing testimony established that many subsidiaries in fact negotiated with IDG for lower rates. For example, Mark Sullivan, CFO of IDC, testified that he entered into negotiations with Edward Bloom, who was at the time IDG’s Controller, to lower the fees that IDC paid for accounting services. Ultimately, IDC negotiated the fee rate for accounting services down from 1.5% to 1.3%, and realized significant savings. Edward Bloom characterized the negotiations with IDG’s subsidiaries as “highly spirited.” Patrick Kenealy, the former President, Publisher and CEO of PC World, testified that he was able to negotiate a lower fee rate for IDG’s accounting services after presenting Edward Bloom with data showing that the services could be procured from other providers at a lower cost.

Additional evidence corroborated Mr. Kenealy’s testimony that other providers charged lower rates than IDG for the same services. Testimony and documentary evidence
entered into the record revealed that when IDG commenced a joint venture with a competitor, Ziff Davis, to form Mac Publishing, LLC ("Mac Publishing"), both Ziff Davis and IDG offered accounting and other services to Mac Publishing. IDG’s rates were significantly higher than those offered by Ziff Davis, and Mac Publishing engaged Ziff Davis for the services rather than IDG.10

Subsidiaries were also free to address their need for administrative services in house. Matthew Smith, Executive Vice President and COO of CW Publishing, testified that during the late 1980s and early 1990s, CW Publishing opted to bring its accounting functions in house, rather than contract with IDG for them. Mr. Smith testified that in so doing CW Publishing saved between $25,000 and $50,000 annually.

One additional fee which IDG charged to each of its subsidiaries was a headquarters fee11 of 1.5% of annual revenue. Unlike the other fees, the headquarters fee was

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10 The record was unclear as to the exact time period when IDG commenced the joint venture with Ziff Davis. While Edward Bloom testified that he believed it was during the early 1990s, other evidence in the record indicated that the joint venture may have commenced during the late 1990s. Regardless of when the joint venture began, the Board found that the testimony and documentary evidence regarding IDG’s joint venture with Ziff Davis was consistent with other evidence of IDG’s business practices during the 1990s and further found it to be probative of the fact that IDG offered administrative services to its subsidiaries at market rates.

11 The parties also intermittently refer to the headquarters fee as a management fee.
not optional and not negotiable.\textsuperscript{12} In return for the headquarters fee, IDG’s subsidiaries received human resource and management services, including a benefits program and access to limited advice and feedback from IDG’s executive staff. Patrick McGovern testified that he spent approximately two hours per month answering questions from various subsidiaries, while Walter Boyd testified that he spent a few hours each week responding to such questions.

However, many of the subsidiaries’ CEOs believed that they received nothing in exchange for the headquarters fee. As Matthew Smith testified, “I don’t think we got anything for that fee... we didn’t get $912,000 worth of benefit.”\textsuperscript{13} Mr. Smith also stated that he would never pay such a fee to an independent consultant. Dr. Irving Plotkin, the appellants’ expert witness, opined that the headquarters fee was tantamount to “highway robbery.”

In fact, evidence was presented that, as a result of litigation brought by executives of PC World, an independent arbitrator determined that IDG’s headquarters fee was excessive. The arbitrator determined that the

\textsuperscript{12} Hereinafter, the headquarters, accounting and marketing services provided by IDG to its domestic subsidiaries will be referred to collectively as “administrative services.”

\textsuperscript{13} $912,000 is the amount that CW Publishing paid in headquarters fees in 1994.
excessive headquarters fee had decreased PC World’s profits which in turn decreased the compensation received by PC World’s executives because it was based in part on profits. The arbitrator ordered IDG to pay additional compensation to those executives.

In addition to looking for new business opportunities and providing services to its subsidiaries, IDG also engaged in the following activities: management of passive investments, the conduct of its own operations, and stewardship activities. Patrick McGovern testified that, during the years at issue, IDG held between $70 and $80 million dollars in passive investments, including certificates of deposit, treasury bills, and municipal notes and bonds. William Murphy, IDG’s Vice President of Finance, testified that he spent approximately 10% to 15% of his time managing IDG’s passive investments, and others in the finance office contributed time to this activity as well.

IDG also devoted resources to conducting its own corporate operations. The parties stipulated and the evidence showed that IDG’s operations activities included “accounting and legal, administrative, information services, corporate communications, human resources, and global image and support activities.”
IDG also engaged in stewardship activities, which are those activities performed by an entity to oversee, preserve, and protect its investment in other entities. Patrick McGovern testified about some of the stewardship activities that IDG performed. IDG required each subsidiary to file monthly as well as annual reports with IDG, which Mr. McGovern and others at IDG reviewed. Further, Mr. McGovern testified that he attended hundreds of board of directors’ meetings a year at IDG’s various subsidiaries around the world. Attending these meetings and reviewing the reports enabled IDG to assess each subsidiary’s performance so that IDG could determine whether to invest further in – or sell – the subsidiary. Mr. McGovern testified that approximately 40% of his time was spent conducting stewardship activities.

2. The Commissioner’s Adjustments

On April 4, 1995, the Commissioner commenced an audit of IDG. Although he was not involved with the audit at its inception, DOR auditor James Hourihan conducted the bulk of the audit and completed it on July 18, 2001.

After noting in the course of the audit that IDG operated at a loss during the years at issue, Mr. Hourihan concluded that, in his opinion, a company such as IDG could not and would not continue to operate at a loss.
Accordingly, Mr. Hourihan made a series of adjustments to the income and expenses of IDG to reflect its operation at “break even.” Mr. Hourihan made these adjustments under G.L. c. 63, § 33 (“§ 33”), which requires the Commissioner to determine the net income of a corporation by “eliminating all payments to [its] parent corporation or affiliated corporations in excess of fair value, and by including fair compensation to such... corporation for all commodities sold to or services performed for the parent... or affiliated corporations.”

Mr. Hourihan reviewed the income and expenses allocated to IDG’s various departments and activities. He identified the following discrete cost areas: the Chairman’s office; long-range planning; research; and treasury. Working in conjunction with IDG’s Vice President of Tax, Jayne Enos, Mr. Hourihan determined that 25% of the expenses associated with the operation of the Chairman’s office were properly attributable to IDG, while 75% of the expenses were properly attributable to IDG’s subsidiaries. As Mr. Hourihan testified at trial, Jayne Enos agreed that 25% of the expenses of the Chairman’s office should “remain with IDG.” Mr. Hourihan then adjusted IDG’s expenses by taking the same 25% figure and applying it to the expenses of nearly all of IDG’s departments, so that 75% of the
expenses associated with those departments thereafter were attributed to IDG’s subsidiaries. Mr. Hourihan testified that the 25% across-the-board adjustment\textsuperscript{14} was arrived at out of a “sense of urgency” to close the audit, which was then approaching its sixth year. Mr. Hourihan stated that his supervisors had instructed him to cease asking for additional information from IDG and conclude the audit.

After these adjustments, IDG’s expenses far exceeded its income for the years at issue. Applying his “break even” methodology, Mr. Hourihan next adjusted IDG’s income for each year at issue, to bring the income in line with the expenses. The premise behind Mr. Hourihan’s adjustments was that IDG was not charging its subsidiaries enough for the administrative services which it provided and should have charged at least enough to cover its expenses. Accordingly, although IDG’s subsidiaries had paid a combined total of nearly $48 million for administrative services during the years at issue, Mr. Hourihan imputed an additional $22.1 of income from the subsidiaries to IDG as fair compensation for the provision of those services. Those adjustments, along with the

\textsuperscript{14} Mr. Hourihan did make a few exceptions to his across-the-board adjustment. For example, Mr. Hourihan allowed the expenses associated with IDG’s Emerging Technologies Division to remain entirely with IDG.
others detailed below in sections E, F, and G, resulted in the assessments at issue in these appeals.

In support of her assessment, the Commissioner argued both that IDG did not charge its subsidiaries enough for services and that it did not charge them for enough services.\textsuperscript{15} For the reasons discussed further in section D(3) and in the Opinion below, the Board disagreed, and decided this issue for the appellants.

3. IDG Received Fair Compensation for the Administrative Services Which it Provided to its Subsidiaries

On the basis of all of the evidence,\textsuperscript{16} the Board found and ruled that IDG received fair compensation for the

\textsuperscript{15} For example, in her post-hearing brief, the Commissioner argued: “IDG is asking this Board to believe that this very successful affiliated group that is comprised of more than 80 operating subsidiaries do not interact with one another, or benefit from... being part of a [sic] affiliated group that primarily engages in the same type of business.... The reality is that IDG had the ability to evaluate things on a broader scale given its experience, as compared to the experience of a single operating subsidiary. IDG simply ignores that members of the IDG management team travelled the globe spending time with IDG’s operating subsidiaries and were hence able to provide view [sic] of the marketplace that each individual operating subsidiary did not have.”

\textsuperscript{16} The parties disagreed about Stipulated Exhibit No. 81, a document referred to by the parties as “the 1994 analysis” ("1994 analysis"). The 1994 analysis was created by IDG long after the years at issue, at the request of the Commissioner, prior to the hearing of these appeals. The 1994 analysis is a lengthy document which analyzes IDG’s activities and expenses for the tax year 1994. According to the 1994 analysis, IDG not only covered its expenses in providing administrative services to its subsidiaries, but actually reaped a profit. The appellants emphasized the 1994 analysis as evidence that IDG received fair compensation for the administrative services which it provided to its subsidiaries. The Commissioner, on the other hand, argued that the Board should disregard the 1994 analysis as unreliable, because it was created by the appellants many years after the years at issue, without documentation to substantiate its data, and in preparation for litigation. The Board decided this issue for the appellants based on
administrative services which it provided to its subsidiaries. There was ample, credible evidence that IDG received market-rate fees for the services which it provided and that it acted at arm’s-length with its subsidiaries in arriving at these fees.

Moreover, the Board found that the Commissioner’s adjustments were fundamentally flawed. After adjustment, nearly all of IDG’s expenses were attributed to the provision of services to its subsidiaries. However, substantial, credible testimony was elicited from IDG’s witnesses regarding IDG’s major activities: the development of new business opportunities; the conduct of its own operations; the provision of administrative services to its subsidiaries; the management of its passive investments; and finally, the stewardship of its investments in its subsidiaries. The majority of IDG’s total expenses were not incurred in activities performed for the benefit of its subsidiaries, and the Board therefore found that the Commissioner’s adjustments to IDG’s expenses and income were improper.

Particularly illustrative of the flaw in the Commissioner’s approach was the fact that one of IDG’s

substantial other evidence in the record and accordingly placed little weight on the 1994 analysis in reaching its decision.
major activities - searching for new business opportunities - was not performed for the benefit of the subsidiaries. Walter Boyd testified that when IDG launched a new subsidiary, Network World, the subsidiaries which published Computerworld and Info World “screamed bloody murder” because they perceived increased competition for coverage of the telecommunications sector. The Board found that IDG’s development of new business opportunities was not an activity in which it engaged for the benefit of its subsidiaries, and in some instances, this activity actually served to increase competition among the subsidiaries for advertisers and subscribers.

The Commissioner’s conclusion that IDG did not receive fair compensation from its subsidiaries was based on no substantive or comparative data. James Hourihan, who conducted the audit of IDG, admitted that he did not even try to talk to the employees of any of the subsidiaries during the course of the audit regarding the services which the subsidiaries received. He made no threshold inquiry as to which of IDG’s activities were feeable or non-feeable, nor did he investigate whether there were comparable market rates for the types of services which IDG provided to its subsidiaries.
The testimony of the appellants' expert witness, Dr. Irving Plotkin, served to highlight the flaws in the Commissioner’s approach. Dr. Plotkin testified that in any transfer pricing analysis “the threshold concern is if there’s been a transaction between A and B, has that been properly priced.... If there was no activity or if A did something which didn’t benefit B, there’s no question of pricing.” According to Dr. Plotkin, once it has been determined that a corporation has engaged in an activity which benefitted a related corporation, the next step in the analysis is to determine how much it would cost the beneficiary of the activity to perform the activity itself or to procure the same services from a third party. This so-called “make or buy” analysis, explained Dr. Plotkin, is premised on the idea that in an arm’s-length transaction, a corporation would never pay more for services from an affiliate than it would pay to an unrelated party or than it would cost to perform the services itself.

In making the adjustments at issue, the Commissioner engaged in no such analysis. Instead, the Commissioner’s adjustments were based on IDG’s overall expenses. As discussed further in the Opinion below, arm’s-length charges may be established by looking at the service provider’s costs, unless the taxpayer furnishes evidence of
a more appropriate arm’s-length charge. In the instant appeals, IDG’s overall expenses were not an appropriate basis for determining arm’s-length charges because many of the activities in which IDG engaged were not performed for the benefit of its subsidiaries, and also because the appellants established, through substantial, credible evidence, that the fees which IDG charged its subsidiaries for administrative services were arm’s-length charges. That evidence included testimony and documents showing that other service providers offered lower fees than IDG for providing the same administrative services as well as the fact that IDG’s subsidiaries had, at times, declined to contract with IDG for the administrative services, opting instead to perform the services for themselves or procure them from another provider.

In support of her position, the Commissioner offered the testimony of Jill Weise, whom the Board qualified as an expert in transfer pricing. However, the Board placed little weight on Ms. Weise’s opinion for a number of reasons.

First, Ms. Weise’s analyses were based on facts which she deemed probable or reasonable, rather than on facts supported by the evidence of record. For example, IDG Chairman Patrick McGovern testified that he spent
approximately 30% of his time searching for new business opportunities, but in her analysis, Ms. Weise allocated just 1% of the expenses of IDG’s chairman’s office to that activity. While IDG President Walter Boyd testified that he spent approximately 20% of his time developing new business opportunities, Ms. Wiese allocated only 1% of the expenses of the president’s office to that activity.

The Board found that Mr. McGovern and Mr. Boyd were in a better position to quantify the amount of time, and money, that IDG spent on various activities than Ms. Weise. Moreover, the testimony offered by Mr. McGovern and Mr. Boyd about their activities was consistent with and supported by other evidence, including the testimony of other IDG executives and the testimony of the employees of IDG’s subsidiaries. Accordingly, the Board placed greater weight on the facts set forth in their testimony than the speculation of the Commissioner’s expert witness.

Second, the Board found that certain aspects of Ms. Weise’s analyses were premised on incorrect assumptions. For example, Ms. Weise testified that the “lion’s share” of IDG’s activities focused on its foreign subsidiaries, and her opinion of what constituted arm’s-length fees for IDG’s administrative services took this fact into consideration. However, it was stipulated by the
parties – and the record showed – that the administrative services were provided to only IDG’s domestic subsidiaries, not its foreign subsidiaries. The Board found that the inclusion of the foreign subsidiaries in Ms. Weise’s analyses undermined the reliability of her opinion.

Similarly, Ms. Weise testified that she adjusted the expenses allocated to IDG’s various departments because she found the allocations suggested by the appellants to be inconsistent with the hearing testimony. Specifically, Ms. Weise allocated a substantial amount of expenses to the subsidiaries based on the hearing testimony that IDG’s executives regularly travelled the globe, attending hundreds of board of directors’ meetings per year at various subsidiaries. Ms. Wiese indicated that because a significant amount of time was dedicated to attending subsidiaries’ board of directors’ meetings, a similarly significant amount of the expenses should be attributed to the subsidiaries.17

However, as Dr. Plotkin clarified during his testimony, it is axiomatic that the principal duty of a member of any corporation’s board of directors is to

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17 To illustrate her point, Ms. Weise testified that, just as stand-alone corporations must pay the expenses of having a board of directors, IDG’s subsidiaries should, too. This assertion, even if accurate, does not justify Ms. Weise’s expense allocations, because IDG’s overall expenses have no correlation to its subsidiaries’ expenses related to maintaining a board of directors.
protect its shareholder’s interests, not the corporation’s interests. In the present appeals, the subsidiaries were wholly owned by IDG, and the Board therefore found that the attendance by IDG’s executives at the subsidiaries’ board of directors’ meetings was primarily for the benefit of IDG, and not the subsidiaries. Therefore, expenses relating to that activity were not feeable to the subsidiaries.

For all of these reasons, the Board found that Ms. Weise’s analyses were premised on speculation and faulty assumptions and accordingly placed little weight on her opinion.

On the basis of all of the evidence, the Board found that IDG received fair compensation from its domestic subsidiaries for the administrative services which it provided. Accordingly, the Board found and ruled that the Commissioner’s adjustments to IDG’s income under § 33 were improper.

**E. The Royalty Issue**

Subsequent to its founding in 1964, IDG quickly expanded by creating subsidiary corporations dedicated to specific market niches within the information technology field. At the same time, IDG created several foreign subsidiaries which published information technology
newspapers or magazines in the language of those foreign countries. During the periods at issue, IDG owned foreign publishing subsidiaries in Switzerland, Sweden, Spain, Norway, Denmark, France, Germany, New Zealand, Australia, and Hungary.

During the late 1980s, IDG sought to create a unifying symbol for its various foreign subsidiaries, so that potential advertisers and customers could readily identify each foreign publication as part of the IDG family. As a result, IDG developed the World Logo, a graphic design which prominently featured the IDG moniker adjacent to a globe-like shape pierced by a series of lines. Patrick McGovern testified that the design of the graphic was intended to indicate, among other things, an affiliation with IDG. According to the application filed with the United States Patent and Trademark Office ("USPTO"), IDG first used the World Logo in 1987.

On October 1, 1988, IDG executed license agreements for the use of the World Logo with nine wholly controlled foreign subsidiaries.¹⁸ The license agreements, which were

¹⁸ Though each license agreement purported to grant the licensee exclusive use of the World Logo, the evidence revealed that the licenses were not exclusive. The uncontroverted evidence is that IDG entered into license agreements with multiple subsidiaries for the use of the World Logo on October 1, 1988 and continued to enter into such agreements thereafter. The record simply does not support a finding
referred to as Logo Agreements, required each licensee to pay a royalty fee equal to 5% of revenue generated from the sale of items displaying the World Logo. On that same day, IDG assigned the license agreements to a Delaware subsidiary, Holdings, by executing an “Assignment of Logo Agreement.”

Holdings was incorporated in Delaware in 1985. Between 1985 and 1988, Holdings was an inactive corporation. During the years at issue, Holdings was not subject to taxation in Massachusetts and was not part of the Massachusetts combined group. Following the Assignment of Logo Agreement, Holdings received the royalty income from IDG’s foreign subsidiaries. Under Delaware law, Holdings paid no state taxes on the royalty income at issue.

Also on October 1, 1988, the executive committee of IDG signed a document, entitled “Consent of the Executive Committee,” ("Executive Consent") which “authorized and directed [IDG] to transfer... the IDG corporate logo to its

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19 The "Assignment of Logo Agreement" entered into evidence referenced Logo Agreements with eight foreign subsidiaries. A ninth Logo Agreement, between IDG and its Australian subsidiary, was executed on October 1, 1988, and that Logo Agreement was also entered into evidence. It was unclear from the documentary evidence entered into the record whether or when that Logo Agreement was assigned to Holdings, but the parties stipulated that all nine of the Logo Agreements were assigned to Holdings on October 1, 1988. Evidence in the record indicated that Holdings received royalty payments from the Australian subsidiary beginning in 1994.

wholly owned subsidiary, IDG Holdings, Inc." The terms of the Executive Consent directed the officers of IDG to "execute and deliver all documents and take all actions necessary" to effectuate the transfer of the World Logo from IDG to Holdings (emphasis added). No additional documents reflecting the transfer of the World Logo to Holdings were entered into evidence, and no testimony was offered regarding further actions taken by IDG to effectuate the transfer of the World Logo. In fact, the appellants' witnesses testified that they could recall no such additional actions or documents.

However, through the testimony of their witnesses and in their post-hearing brief, the appellants asserted that IDG transferred the World Logo to Holdings on October 1, 1988. Further, through the testimony of their expert witness, Ethan Horwitz, the appellants argued that documentary evidence of the transfer of a trademark is not necessary to prove its transfer, as such a transfer may be established by the clear and uncontradicted oral testimony of a party with knowledge of the transfer. The Board, however, found that the testimony offered by the appellants to establish the transfer of the World Logo was in fact contradicted by the evidence and therefore rejected this argument.
The evidence of record contradicted the assertion that IDG transferred the World Logo to Holdings at any time prior to or during the years at issue. No transfer of the World Logo from IDG to Holdings was recorded with the USPTO. Similarly, evidence entered into the record revealed that IDG registered the World Logo in its own name in foreign jurisdictions.

Further, on October 1, 1991, IDG entered into a license agreement for the use of the World Logo with an Hungarian subsidiary, despite having allegedly transferred the World Logo to Holdings in 1988. As it had with the others, IDG transferred the October 1, 1991 license agreement to Holdings on that same day by entering into an Assignment of Logo Agreement with Holdings. The October 1, 1991 Assignment of Logo Agreement referred to IDG as the owner of the “tradename IDG and the related logo.”

Moreover, IDG continued to exert control over the use and display of the World Logo. IDG’s own corporate communications office created the “IDG Style and Idea Book,” (“Style and Idea Book”) a manual which directed IDG’s subsidiaries how to properly use and display the World Logo. The Style and Idea Book contained no mention of Holdings, and in fact, the contact address listed in the Style and Idea Book was Massachusetts, not Delaware. The
parties even stipulated that one of IDG’s operations activities included “global image and support activities.”

In addition, IDG continued to use the World Logo – including displaying the World Logo on its Corporate Values Plaque, letterhead, and business cards – although it did not enter into a license agreement with Holdings and did not pay Holdings for the use of the World Logo. The evidence of record simply refuted the assertion that IDG transferred the World Logo to Holdings. Accordingly, the Board found that IDG did not in fact transfer the World Logo to Holdings prior to or during the years at issue.

Additionally, the Board found that Holdings did not engage in substantive business activity. During the years at issue, Holdings had no employees and incurred no expense for salaries. While it had officers and directors, those officers and directors were either employees of IDG or the Bank of Delaware and were not paid by Holdings. There was conflicting evidence in the record as to when Holdings first leased office space. Mr. Murphy testified that Holdings had consistently leased an office since 1988 and records of Holdings’ expenses for 1992 showed nominal amounts paid for rent. However, the only lease entered into evidence commenced on November 10, 1993. On that date, Holdings entered into a lease for an “unspecified
portion of an office suite” with the Bank of Delaware for the minimal sum of $250 per month.

The evidence indicated that Holdings conducted no activities with respect to the protection and maintenance of the World Logo, nor did it pay for the expenses of maintaining or defending the World Logo. Throughout the years at issue, IDG, not Holdings, bore the responsibility for the management and maintenance of the World Logo. All trademark registration and maintenance duties with respect to the World Logo were performed by Miriam Karlin, a paralegal employed by IDG. Ms. Karlin was not compensated by Holdings for her work, nor did Holdings pay a fee to IDG for her services. Holdings did not incur any legal fees or other costs for the registration, maintenance, or defense of the World Logo during the years at issue, nor did it license the World Logo to third parties.

In addition to retaining the responsibility for the management of the World Logo, IDG maintained control of the World Logo throughout the years at issue. Though the appellants asserted that IDG transferred the World Logo to Holdings in 1988, as discussed above the evidence of record contradicted that assertion. Moreover, IDG retained access to and made use of the royalty income derived from the licensing of the World Logo.
The royalty fees received by Holdings during the years at issue – which totaled $6,601,498 for 1992, $6,222,345 for 1993, and $6,667,655 for 1994 – were deposited into its bank account at the Bank of Delaware. When that bank account reached a certain level, funds were automatically swept from the account into an investment account which Holdings maintained with Merrill Lynch. Holdings’ investment policies required that not less than 80% of its total investments be made in instruments with a maturity of no longer than 180 days, and at least half of that 80% was required to consist of instruments with a maturity of no longer than 49 days.

Evidence entered into the record showed that IDG had access to Holdings’ Merrill Lynch account during the years at issue and “borrowed” funds from that account without making full repayment. These “loans” from Holdings to IDG were made without the benefit of an instrument evidencing the debt and continued to be made despite the fact that IDG had not repaid previous loans. Holdings did not charge interest to IDG on the money which IDG “borrowed.”

On the basis of all of the evidence, the Board found that prior to and during the years at issue, IDG did not transfer the World Logo to Holdings. Assuming arguendo that IDG did transfer the World Logo to Holdings, the Board
further found that that transfer, together with the transfer of the license agreements ("transfers at issue") had no practical economic effect other than the creation of tax benefits. The record does not support a finding that Holdings did anything other than receive royalty income from license agreements which it did not negotiate, for the use of a trademark which it did not own and for which it did not pay the maintenance expenses. Moreover, IDG’s position with respect to the World Logo did not change as a result of the transfers at issue. It maintained possession, use and control of the World Logo, bore the responsibility and expense for its maintenance, and had access to and made use of the royalty income from the license agreements.

Furthermore, the Board found that the transfers at issue had no business purpose and were undertaken solely for the avoidance of Massachusetts tax. Through the testimony of their witnesses at trial and in their post-hearing briefs, the appellants asserted that the business purpose for the transfers at issue was to further IDG’s corporate value of decentralization, whereby subsidiaries – rather than the parent corporation – carried on active business functions. In other words, the appellants argued, the transfers at issue were just another example of IDG’s
decentralized method of doing business. The Board found, however, that the evidence of record did not support that assertion. In fact, the operation of Holdings stood in stark contrast to that of the typical IDG subsidiary.

The transfers at issue were anomalous to IDG’s established business practices. The hearing testimony established that IDG held thousands of trademarks used by its many subsidiaries, but the World Logo was the only trademark for which a royalty fee was charged.

As Patrick McGovern testified, IDG’s core value of decentralization meant that each subsidiary had its own employees; Holdings did not. Numerous witnesses, including Patrick McGovern, Matthew Smith, Mark Sullivan, and Walter Boyd, testified regarding the mandatory headquarters fee of 1.5% of revenue that each IDG subsidiary was required to pay to IDG; Holdings was not. Many of those same witnesses testified regarding the mandatory monthly and annual reports that each subsidiary was required to file with IDG; Holdings was not. The Board inferred from these anomalies that Holdings was not intended to function – and did not function – as anything other than a passive vessel in Delaware into which IDG diverted royalty income that would otherwise be taxable in Massachusetts.
Further, as stated in the appellants’ post-hearing brief, “[a]t trial, IDG expressed several additional reasons for the transfer.” For example, the appellants asserted that isolation from “potential legal issues and liabilities associated with the World Logo” and the protection of the mark in the event of bankruptcy were business reasons for having Holdings own the World Logo. However, no contemporaneous documents or other evidence supporting any of the asserted non-tax business reasons were offered into evidence.

The Board found none of these “additional reasons” credible, as the appellants presented no evidence that the transfers at issue either could or did accomplish the asserted goals, nor any evidence that they were of concern to IDG at the time of the transfers at issue. Further, Lee Bromberg, Esq., who testified for the Commissioner as an expert in the field of trademark law and practice, testified that the transfers at issue offered no advantages from a trademark law perspective, and in fact, resulted in several potential disadvantages.

For example, Mr. Bromberg explained that a trademark is essentially an expression of goodwill, a symbol to consumers of what they can expect from a particular company or product. He testified that the goodwill associated with
the World Logo resided with IDG, whose moniker was its most prominent feature. He further testified that the transfer of the World Logo to Holdings, absent the transfer of the corresponding goodwill, could be challenged under trademark law as an assignment in gross, or in other words, as an invalid assignment. Mr. Bromberg opined that such an assignment could diminish the value and significance of the World Logo rather than enhance its value or otherwise protect the trademark.

Based on all of the evidence, the Board found and ruled that the transfers at issue were entered into solely for the avoidance of Massachusetts tax and had no practical economic effect other than the creation of tax benefits. Further, the Board found and ruled that, following the transfers at issue, IDG retained sufficient power and control over both the World Logo, the license agreements and the royalty income at issue to be taxed as the beneficial recipient of that income. Accordingly, the Board found that the transfers at issue were sham transactions which resulted in the improper assignment of income, and therefore the Commissioner’s reallocation of that income to IDG was proper.

21 In their post-hearing reply brief, the appellants asserted that the Commissioner raised the assignment-of-income argument for the first time in her post-hearing brief, thus making it an untimely raised
F. The Apportionment Issue

As discussed in section C above, the Board found and ruled that the Commissioner in fact abated the assessments against CW Publishing, and following the abatements there were no valid assessments remaining against CW Publishing for the years at issue. However, even if the Commissioner had not abated the assessments, the Board found and ruled that CW Publishing was entitled to the abatements because the Commissioner's adjustments to its sales factor were improper.

During the years at issue, CW Publishing was the publisher of Computerworld, a weekly newspaper targeting information technology executives in the United States. CW Publishing's corporate headquarters were located in Massachusetts, and it had regional advertising sales offices located in California, Georgia, Illinois, Massachusetts, New Jersey, Texas, Virginia and Washington. Salespeople within the regional offices were assigned to
specific geographic regions.\textsuperscript{22} According to Executive Vice President and COO Matthew Smith, the salespeople frequently travelled to other states within their assigned regions to solicit advertising and attend trade shows. Evidence entered into the record, including expense reports, showed that during the years at issue, salespeople worked in the following states: Alabama, Arizona, Colorado, Connecticut, Florida, Iowa, Kansas, Kentucky, Maryland, Michigan, Missouri, Nebraska, Nevada, North Carolina, New York, Ohio, Oregon, Pennsylvania, South Carolina and Utah.

Mr. Smith also testified regarding CW Publishing’s subscription sales. He explained that subscription sales were made in two ways. First, CW Publishing had subscription sales offices located in California and New Jersey, which generated subscription sales by mailing millions of direct-mail solicitations every year.

In addition, CW Publishing made subscription sales through the “bind-in” or “blow-in” cards (“cards”) commonly found inserted in periodicals. If a customer wished to subscribe to Computerworld, the customer could remove and fill out the card, then send it to the designated address, which was in Marion, Ohio. The processing of the cards was

\textsuperscript{22} For example, the Massachusetts sales office covered the following territory: Connecticut, Maine, Massachusetts, New Hampshire, New York, Pennsylvania, Rhode Island and Vermont.
handled by Kable Fulfillment, a third-party company located in Marion. Kable Fulfillment handled all aspects of the subscription orders, including receiving payment and tracking orders. Computerworld newspapers were printed by a third-party printer, located in Wisconsin, and mailed directly to subscribers from there.

Because CW Publishing and several of IDG’s other publishing subsidiaries conducted business in many states, they were eligible to apportion their income in determining their Massachusetts corporate excise. Pursuant to G.L. c. 63, § 42 ("§ 42"), IDC, as the principal reporting corporation for the group, applied to the Commissioner to use a method of apportionment for its publishing affiliates other than that set forth in G.L. c. 63, § 38, ("§ 38"), and the Commissioner approved IDC’s application. For each of the years at issue, the alternative method selected by IDC and approved by the Commissioner was that contained in proposed regulations which had been drafted by the Commissioner, but which were never finally adopted. Proposed regulation 830 CMR 63.38j.4 ("1989 proposed regulation") was drafted in 1989 and offered an alternative method of apportionment for broadcasters and publishers. The 1989 proposed regulation was replaced by 830 CMR 63.38.6 - Apportionment of Income by Publishers ("1993

For the 1992 tax year, IDC’s § 42 application was approved as part of a litigation settlement between the Commissioner and IDC. For the 1993 tax year, the Commissioner’s approval of IDC’s applications for alternative apportionment contained the following terms: “[T]he department accepts [IDC and its subsidiaries’] proposed method of alternative apportionment... to the extent that it is consistent with proposed regulation 830 CMR 63.38.6.” (emphasis added). Similarly, for the 1994 tax year, the Commissioner’s approval contained the following language: “The applicant’s proposed method of apportionment is based on 830 CMR 63.38.6... the Department accepts the method of alternative apportionment proposed by [IDC and its subsidiaries].”

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23 The 1989 proposed regulation encompassed apportionment of income for publishers and broadcasters. The Commissioner’s 1993 revisions to the proposed regulation bifurcated the two industries, resulting in separate proposed regulations. Proposed regulation 830 CMR 63.38.5 addressed apportionment of income for broadcasters.

24 The Commissioner’s adjustments to CW Publishing’s sales factor for the 1992 tax year were de minimis. Therefore, like the parties, the Board focused its discussion of this issue on the 1993 and 1994 tax years and the 1993 proposed regulation.
Both approvals further stated: “This determination governs with respect to the specified tax period and the method of apportionment of income only, and does not preclude adjustment in audit with respect to other issues not related to the method of apportionment.”

During the course of the audit for the years at issue, auditor James Hourihan determined that CW Publishing did not correctly apportion its income. Mr. Hourihan concluded that CW Publishing did not treat as Massachusetts sales those sales from other states in which it had no sales office and in which it was not taxable, as required by the “throwback rule” of § 38(f). Accordingly, Mr. Hourihan included those sales in the numerator of CW Publishing’s sales factor, which in turn increased its excise.

CW Publishing contested the adjustments to its sales factor for two reasons. First, it contended that the Commissioner, having approved IDC’s application to use an alternative formula, was bound by her approval and precluded from making an adjustment relating to the apportionment formula. In addition, CW Publishing argued that even if the Commissioner was not precluded from making an adjustment by virtue of her prior approval, the adjustments made by the Commissioner were improper because sales which were made in states in which CW Publishing was
taxable were erroneously included as Massachusetts sales for the purpose of the sales factor.

On the basis of all of the evidence, the Board found and ruled that the Commissioner’s approval of an application to use an alternative apportionment formula under § 42 did not preclude the Commissioner from making an adjustment relating to the apportionment calculation. However, the Board found and ruled that CW Publishing correctly applied the approved apportionment formula. The activities of CW Publishing’s salespeople in states other than those in which CW Publishing maintained a sales office were sufficient to render CW Publishing taxable in those states. The Board therefore found that the Commissioner improperly included sales from those states in the numerator of CW Publishing’s sales factor. Accordingly, the Board decided this issue for appellant CW Publishing.

G. World Expo Failed to Meet Its Burden of Proof

Appellant World Expo appealed from the Commissioner’s refusal to abate corporate excise for the World Expo years at issue, alleging in its Petition that the Commissioner improperly adjusted the sales factor of its apportionment percentage by misallocating income from the sale of intangible property. However, World Expo offered no evidence at the hearing of these appeals. Further, in the
appellants’ post-hearing brief, the only argument set forth relating to World Expo concerned the timeliness of the Commissioner’s assessments. As discussed above, the Board found and ruled that this argument lacked merit, as the evidence showed that the assessments against all of the appellants were timely. Therefore, the Board found and ruled that World Expo did not meet its burden of proving its right to an abatement and issued a decision for the appellee in Docket No. C268725.

III. Summary of Findings

With respect to appellant IDC, on the basis of all of the evidence, the Board found and ruled that IDG received fair compensation for the administrative services which it provided to its subsidiaries and that the Commissioner improperly imputed additional income to IDG for those services. Further, the Board found and ruled that the transfer of the license agreements and the purported transfer of the World Logo to Holdings were sham transactions that lacked economic substance and business purpose and resulted in an improper assignment of income. The Board therefore found and ruled that the Commissioner properly reallocated the royalty income at issue to IDG.

With respect to appellant CW Publishing, on the basis of all of the evidence, the Board first found and ruled
that the Commissioner had abated the assessments against CW Publishing and following the abatements there were no valid assessments remaining against CW Publishing for the years at issue. Further, the Board found and ruled that CW Publishing timely filed its Petition with the Board and that CW Publishing was entitled to the abatements on the merits. Although the Board concluded that the Commissioner was not legally precluded from making an adjustment related to the apportionment calculation following the approval of an application for alternative apportionment under § 42, it found and ruled that CW Publishing correctly applied the approved alternative apportionment method and therefore the Commissioner’s adjustments to CW Publishing’s sales factor were improper.

Lastly, the Board found and ruled that World Expo offered no evidence into the record in these appeals, and accordingly did not meet its burden of proving that it was entitled to an abatement.

Based on these findings, and in accordance with the agreed upon computations submitted by the parties under Rule 1.33 for Docket Nos. C267868 and C271245, the Board ordered abatements of corporate excise to IDC in the amount of $253,300 for 1992, $634,479 for 1993, and $678,384 for 1994, together with penalties and interest; and abatements
of corporate excise to CW publishing in the amount of $14,274 for 1992, $82,028 for 1993, and $100,217 for 1994, together with penalties and interest. The Board issued a decision for the appellee in Docket No. C268725.

OPINION

The issues presented in these appeals are: (1) whether the Commissioner properly adjusted IDG’s income to reflect fair compensation for administrative services provided by IDG to its domestic subsidiaries; (2) whether royalty income paid to Holdings was properly reallocated by the Commissioner to Holding’s parent corporation, IDG; (3) whether the Commissioner abated the assessments against CW Publishing; (4) whether CW Publishing timely filed its Petition; (5) whether the Commissioner may make adjustments relating to the apportionment formula after approving the use of an alternative apportionment formula under § 42; and (6) whether the Commissioner properly adjusted the sales factor of the apportionment formula for the purposes of calculating CW Publishing’s corporate excise.

I. The Commissioner Was Not Justified in Exercising Her Authority Under § 33 to Adjust IDG’s Income

A. Introduction

Section 33 gives the Commissioner the authority to adjust the income of a domestic corporation to reflect fair
compensation received from services provided to affiliated corporations. G.L. c. 63, § 39A ("§ 39A") is the related statute which applies to foreign corporations. The purpose of §§ 33 and 39A is to prevent a corporation from "artificially depress[ing]" its taxable net income by entering into "less than arm’s-length transactions between affiliates." Polaroid Corp. v. Commissioner of Revenue, 393 Mass. 490, 497 (1984).

The pertinent language of § 33 provides that:

The net income of a domestic business corporation which is a subsidiary or parent corporation of another corporation or closely affiliated therewith by stock ownership shall be determined by eliminating all payments to the parent corporation or subsidiary or affiliated corporations in excess of fair value, and by including fair compensation to such domestic business corporation for all commodities sold to or services performed for the parent corporation or subsidiary or affiliated corporations.

Accordingly, a threshold determination to be made in assessing the propriety of a § 33 adjustment is whether a service has been performed for an affiliate.

Internal Revenue Code ("I.R.C.") § 482 is the federal provision on which §§ 33 and 39A are based, and this Board and the Supreme Judicial Court have looked to it for guidance in interpreting those sections. See Syms Corp. v.
Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 2000-711, 770, aff’d, 436 Mass. 505 (2002) (citing AMI Woodbroke, Inc. v. Commissioner of Revenue, 418 Mass. 92, 96 (1994)). Though the Commissioner has not promulgated regulations pertaining to §§ 33 and 39A, the Internal Revenue Service has issued extensive regulations regarding the appropriate application of I.R.C. § 482. Those regulations provide guidance as to when an entity must charge an affiliate for a particular service, as well as how much it should charge.

Under the regulations, an affiliate need not pay for services if “the probable benefits... were so indirect or remote that unrelated parties would not have charged for such services.” Treas. Reg. § 1.482-2(b)(2)(i) (1968). In making the adjustments at issue, the Commissioner did not apply this test to IDG’s activities and instead merely imputed additional income to IDG for the provision of services so that its income “broke even” with its expenses.

In support of her adjustments, the Commissioner argued that IDG’s subsidiaries did not pay enough for services and that the subsidiaries did not pay for enough services. Those arguments were incorrect for a number of reasons,

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25 The regulations under I.R.C. § 482 applicable to the years at issue were enacted in 1968, but were substantially revised effective January 1, 2007.
among them: IDG received fair compensation for the services which it provided; IDG in fact received compensation for some of the services which the Commissioner claimed it did not; and the activities in which IDG engaged did not constitute services provided to an affiliate within the meaning of § 33.

B. IDG Received Fair Compensation for Accounting and Marketing Services

IDG offered to all of its domestic subsidiaries accounting services, and to its domestic subsidiaries engaged in publishing, IDG offered marketing services. The fee rate for the accounting services was typically 1.5% of the subsidiary’s annual revenue, while the fee rate for the marketing services was typically between 1% and 2.5% of the subsidiary’s annual revenue. The Commissioner imputed additional income to IDG under § 33 as “fair compensation” for these services.

“In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer.” Treas. Reg. § 1-482-1(b)(1) (1968). In general, the service provider’s cost of providing services will be deemed the arm’s-length charge, “unless the taxpayer establishes a more appropriate charge[.]”
Treas. Reg. § 1.482-2(b)(3)(1968). In the instant appeals, the Board found that IDG’s expenses were not an appropriate basis for determining arm’s-length rates because the appellants presented substantial, credible evidence which established that the actual rates charged by IDG for its accounting and marketing services were arm’s-length rates.

The record revealed that the rates were negotiable and the hearing testimony established that some of the subsidiaries did, in fact, negotiate with IDG for lower rates. For example, Mark Sullivan, CFO of IDC, testified that he entered into negotiations with Edward Bloom, who was at the time IDG’s Controller, to lower the fees that IDC paid for accounting services. Ultimately, IDC negotiated the fee rate for accounting services down from 1.5% to 1.3%, and realized significant savings. Similarly, Patrick Kenealy, the former President, Publisher and CEO of PC World, testified that he was able to negotiate a lower fee rate for IDG’s accounting services after presenting Edward Bloom with data showing that the services could be procured from other providers at a lower cost.

Subsidiaries were also free to engage other, independent providers for administrative services, or to address their need for those functions in house. Matthew Smith, Executive Vice President and COO of CW Publishing,
testified that during the late 1980s and early 1990s, CW Publishing opted to bring its accounting functions in house, rather than contract with IDG for them. Mr. Smith testified that in so doing, CW Publishing saved between $25,000 and $50,000 annually.

Additional evidence entered into the record indicated that other providers charged lower rates than IDG for the same services. Testimony and documentary evidence regarding IDG’s joint venture with a competitor, Ziff Davis, to form Mac Publishing revealed that both Ziff Davis and IDG offered accounting and other services to Mac Publishing. IDG’s rates were significantly higher than those offered by Ziff Davis, and Mac Publishing engaged Ziff Davis to perform the services rather than IDG.

On the basis of this evidence, the Board found and ruled that IDG acted at arm’s length in its dealings with its subsidiaries with respect to the accounting and marketing fees. The fees were optional and negotiable, and were in fact negotiated by many of the subsidiaries. The evidence also indicated that IDG charged at least as much, and possibly more, than its competitor Ziff Davis, for the provision of accounting and other services. The Board found no indication in the record that the fees IDG received from its subsidiaries for accounting and marketing
services were less than the fees which unrelated entities would pay for the same services, nor any other indication that IDG did not receive fair compensation for its services.

Because the appellants established that IDG received arm’s-length fees for the provision of the accounting and marketing services, the Commissioner’s use of its expenses to determine “fair compensation” was erroneous. Treas. Reg. § 1.482-2(b)(3) (1968). The Commissioner has the authority to adjust income under § 33 only to the extent that income does not reflect fair compensation. See The Sherwin-Williams Company v. Commissioner of Revenue, 438 Mass. 71, 95 (2002). Accordingly, the Board found and ruled that the accounting and marketing fees were not properly subject to adjustment under § 33.

C. IDG Received Fair Compensation for Management Services

The Commissioner argued that IDG rendered valuable management services to its subsidiaries for which it did not receive fair compensation. For example, in her post-hearing brief, the Commissioner stated:

IDG is asking this Board to believe that this very successful affiliated group that is comprised of more than 80 operating subsidiaries do not interact with one another, or benefit from... being part of a [sic] affiliated group
that primarily engages in the same type of business.... The reality is that IDG had the ability to evaluate things on a broader scale given its experience, as compared to the experience of a single operating subsidiary. IDG simply ignores that members of the IDG management team travelled the globe spending time with IDG’s operating subsidiaries and were hence able to provide view [sic] of the marketplace that each individual operating subsidiary did not have.

The Board agreed with the Commissioner’s conclusion that IDG’s subsidiaries benefitted from their affiliation with IDG and their access to its experienced executive staff. However, what the Commissioner in turn ignored was that IDG did receive compensation for its management services, in the form of the headquarters fee.

In return for the headquarters fee, the subsidiaries received certain human resource services – such as inclusion in a benefits program – and limited advice upon request from IDG’s executives. Patrick McGovern testified that he spent approximately two hours per month answering questions from various subsidiaries, while Walter Boyd testified that he spent a few hours each week responding to such questions. IDG provided management services to its subsidiaries, but the evidence indicated that providing management services to its subsidiaries constituted just a fraction of IDG’s activities. The Board could find no
evidence in this record that the headquarters fee which IDG received was less than fair compensation for those services.

The evidence of record revealed that the headquarters fee represented at least fair value for services, and possibly more. Unlike the accounting and marketing services, the headquarters fee charged by IDG was not the result of “spirited negotiations.” The testimony revealed that it was a compulsory, non-negotiable fee, in the amount of 1.5% of revenues, charged to each domestic subsidiary. Several of the appellants’ witnesses testified that the subsidiaries received few services in return for the headquarters fee. Matthew Smith testified that CW Publishing got nothing in return for the headquarters fee. He further testified that he would never pay an independent consultant an equivalent management fee. Dr. Plotkin opined that the headquarters fee was tantamount to “highway robbery.”

In addition, evidence was presented that as a result of litigation brought by executives of PC World, an independent arbitrator determined that IDG’s headquarters fee was excessive. The arbitrator determined that the excessive headquarters fee had decreased PC World’s profits, which in turn decreased the compensation received.
by PC World’s executives because it was based in part on profits. The arbitrator ordered IDG to pay additional compensation to those executives. The Board found this to be compelling evidence that the headquarters fee received by IDG was not less than fair compensation.

Moreover, the fact that IDG executives spent considerable time attending subsidiaries’ board of directors’ meetings, reviewing their reports, and even answering their questions was not dispositive of whether those activities were feeable. It has long been recognized that a parent corporation may undertake certain activities to protect its investment in its subsidiaries, a practice known as stewardship. See Tech. Adv. Mem. 88-06-002 (Sept. 24, 1987); Eli Lilly & Co. v. Commissioner of Internal Revenue, 84 T.C. 996, 1155 (T.C. 1985), aff’d in part, rev’d in part, 856 F.2d 855 (7th Cir. 1988). As stated in the seminal Young & Rubicam case:

The fact question is whether they performed general supervisory services for plaintiff or they performed managerial services for a subsidiary for which the subsidiary would have paid a fee had they been performed by an unrelated corporation. Our conclusion is that the activities proved were general supervision for plaintiff and that no support exists in this record for the allocation. Supervisory functions such as these are not subject to allocation under 482.
Young & Rubicam, Inc. v. United States, 410 F.2d 1233, 1245 (Ct. Cl. 1969). After considering facts similar to those in the instant appeals, where employees of a parent company travelled abroad and provided certain limited management services to subsidiaries, the United States Court of Claims concluded that the employees’ activities were more supervisory in nature, undertaken to benefit the parent company, not the subsidiaries.

We think that the above summary shows that the activities relied on by defendant to support the Commissioner's allocation were part of plaintiff's attempt to control its subsidiaries, their personnel and offices. There is no evidence that these four individuals performed specific managerial services for specific subsidiaries, and therefore we must conclude that the allocation is not supported by the record and that the Commissioner's allocation was improper.

Id. at 1247. Likewise, in the present appeals, there was no evidence that IDG performed specific managerial activities for its subsidiaries. Indeed, there was substantial evidence that IDG eschewed hands-on management of its subsidiaries in favor of a more laissez-faire approach, consistent with its decentralized business model.

The Board therefore found and ruled that the majority of the oversight activities engaged in by IDG were more in the nature of general supervisory activities than specific
management services, and therefore were not “services performed for an affiliate” for the purposes of § 33. Moreover, the Board found and ruled that IDG received fair compensation, in the form of the headquarters fee, for the limited management services which it did provide to its subsidiaries. Accordingly, the Board found and ruled that fees received by IDG for management services were not subject to adjustment under § 33.

D. The Commissioner Failed to Distinguish Between IDG’s Feeable and Non-Feeable Activities

Dr. Plotkin testified that once a specific corporate activity has been identified, the next question in analyzing an adjustment under § 33 is whether that activity was performed for the benefit of an affiliate such that it is a feeable activity. The regulations for the analogous federal statute provide that a service is not feeable if “the probable benefits... were so indirect or remote that unrelated parties would not have charged for such services.” Treas. Reg. § 1.482-2(b)(i) (1968).

The evidence presented at the hearing of these appeals revealed that IDG engaged in numerous activities beyond the provision of administrative services to its subsidiaries. For example, IDG searched for new business opportunities. IDG’s operational focus was the identification of new
opportunities in the information technology market and the creation of new subsidiaries to exploit those opportunities. William Murphy testified that it was a bad year if IDG didn’t form at least two or three new subsidiaries. Patrick McGovern – who was described as a serial entrepreneur – estimated that he spent approximately 30% percent of his time searching for new business opportunities.

There was no evidence that IDG’s creation of new subsidiaries was a service performed for the benefit of its existing subsidiaries. In fact, the hearing testimony revealed that IDG’s newly formed subsidiaries created competition for advertising and market share for its existing subsidiaries. Walter Boyd testified that when IDG launched a new subsidiary, Network World, the subsidiaries which published Computerworld and Info World “screamed bloody murder” because they perceived increased competition for coverage of the telecommunications sector.

Another activity in which IDG engaged was the management of its own passive investments. Patrick McGovern testified that, during the years at issue, IDG held between $70 and $80 million dollars in passive investments, including certificates of deposit, treasury bills, municipal notes and bonds. William Murphy, IDG’s
Vice President of Finance, testified that he spent approximately 10% to 15% of his time managing IDG’s passive investments, and others in the finance office contributed time to this activity as well. Similarly, substantial, credible testimony as well as the stipulated facts established that IDG conducted its own operations, such as human resources, accounting and communications. There was no evidence that the management of IDG’s passive investments or the conduct of its own operations conferred a direct benefit upon its subsidiaries. Nevertheless, the Commissioner’s adjustments did not make an allowance for expenses relating to these activities.

The primary flaw of the Commissioner’s “break even” theory was that it did not adequately distinguish between IDG’s feeable and non-feeable activities, but was based instead on IDG’s overall costs. In certain circumstances, the costs of providing a service can be an appropriate basis for pricing intercompany transactions.\textsuperscript{26} However, no adjustment can be made when the activities were not undertaken for the benefit of another entity. There was no evidence that the subsidiaries received a direct benefit from IDG’s management of passive investments, search for new business opportunities, creation of new subsidiaries,

\textsuperscript{26} See Treas. Reg. § 1.482-2(b)(3) (1968)
or the conduct of IDG’s own internal operations to the extent that they would have paid an independent service provider for them. Treas. Reg. § 1.482-2(b)(i) (1968). The Board therefore found that they were not services performed for an affiliate within the meaning of § 33.

Moreover, the fact that a subsidiary may have received a service for which it did not pay does not, by itself, justify an allocation of income. In considering an allocation of income made under a Georgia statute which has language virtually identical to § 33, the Court of Appeals of Georgia held that “[w]hile the undisputed facts do show... that the parent performed some services for the subsidiaries without making specific charges, these facts do not necessarily reveal a distortion of true net income.” Blackmon v. Campbell Sales Co., 125 Ga. App. 859, 863 (1972). Additionally:

The Tax Court has recognized limitations upon the applicability of Section 482. Section 482 does not permit the reallocation of income merely because a controlling entity has the power to shift income. A reallocation under Section 482 must be based upon an actual shifting of income. Section 482 is not designed to punish the mere existence of commonly controlled entities nor the unexercised power to shift income among them.

Merck & Co., Inc. v. United States, 24 Cl. Ct. 73, 80 (1991).
The rulings in these cases are consistent with the legislative purpose behind §§ 33 and 39A and similar federal and state statutes, which is to prevent a corporation from “artificially depress[ing]” its taxable net income.” *Polaroid Corp.*, 393 Mass. at 497. The Board found no evidence that IDG was “artificially depressing” its taxable net income by charging less than fair value for services provided to its subsidiaries.

The testimony of the Commissioner’s expert witness, Jill Weise, offered little support for the Commissioner’s adjustments. The Board found that Ms. Weise’s analyses were premised on facts contrary to those supported by the evidence of record and on flawed assumptions. In short, the Board found that her testimony, though “intellectually stimulating and interesting, was... concerned with hypothetical models that had little discernible relationship to actual activities [of the taxpayer].” *Merck & Co., Inc.*, 24 Cl. Ct. at 89. Therefore, the Board placed little weight on Ms. Weise’s opinion.

In reaching its decision on this issue, the Board was mindful that the burden of proof is on the party seeking an abatement. *Staples v. Commissioner of Corporations and Taxation*, 305 Mass. 20, 26, (1940). However, “[t]axing statutes must be strictly construed, and liability to a tax
must be founded in the express terms of a statute. Such liability cannot arise merely by implication from some statutory provision.” Commissioner of Corporations & Taxation v. Tousant, 309 Mass. 84, 85 (1941) (citations omitted). In the present appeals, there was no support in the statute for the Commissioner’s assessment, as it was based largely on the imputation of income for services that were not performed for the affiliates as required by § 33. The Commissioner’s assessment was also unwarranted because it was based on the imputation of additional income to reflect “fair compensation” when IDG had in fact received fair compensation for the services which it performed for its subsidiaries. In sum,

[T]he Board found the auditor's method severely flawed.... [T]he auditor's analysis was predicated on impermissible presumptions and dubious assumptions and was thus unreliable and invalid. As in Chef Chang's, the Board found and ruled here that the auditor's analysis in the present appeals was "based on speculative data" making no allowances for non-taxable transactions, and therefore did not support the... assessment.

Food Service Associates, Inc. and Dennis G. Maxwell v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports, 2001-341, 363-64 (quoting Chef Chang’s House, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1996-738, 751). Accordingly, the Board found and
ruled that the Commissioner’s adjustments under § 33 were improper and decided this issue for the appellants.

II. The Commissioner Properly Reallocated the Royalty Income at Issue to IDG

   A. The Substance-Over-Form Doctrine

   The present appeals raise the issue of whether certain intercompany transactions may be disregarded for tax purposes because those transactions lacked economic substance and were entered into merely for the avoidance of tax. It has long been held in Massachusetts that “substance should prevail over form.” Spirit of Yankee, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1998-723, 733 (quoting American Potash & Chem. Corp. v. United States, 399 F.2d 194, 207 (Ct. Cl. 1968)). The substance-over-form doctrine is well established in tax cases. “[T]he courts have... invoked a variety of doctrines... to disregard the form of a transaction where the facts show that the form of the transaction is artificial and entered into for the sole purpose of tax avoidance and there is no independent purpose for the transaction.” Falcone v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1996-727, 734-35.

   Among the “variety of doctrines” falling under the substance-over-form umbrella are the sham transaction
doctrine, the step transaction doctrine, and the anticipatory assignment-of-income doctrine ("assignment of income").

The Commissioner advanced both the sham transaction and assignment-of-income theories in support of her assessments, and the Board is of the opinion that an analysis under both theories was warranted by the facts of these appeals. The Board therefore conducted its analysis under both approaches, reaching the same conclusion in each, i.e., the Commissioner properly reallocated to IDG royalty income paid to its Delaware subsidiary, Holdings, by IDG’s foreign subsidiaries.

B. The Transfers at Issue were Sham Transactions

"Massachusetts recognizes the 'sham transaction doctrine' that gives the commissioner the authority 'to disregard, for taxing purposes, transactions that have no economic substance or business purpose other than tax avoidance.'" Sherwin-Williams, 438 Mass. at 79 (quoting Syms, 436 Mass. at 509-510). The doctrine "works to prevent taxpayers from claiming the tax benefits of transactions that, although within the language of the tax code, are not the type of transactions the law intended to favor with the benefit." Syms, 436 Mass. at 510 (citing

In analyzing this issue in the present appeals, the Board was cognizant of the fundamental principle that every taxpayer has the right to decrease the amount of taxes owed, or avoid them altogether, by any legal means. See Gregory v. Helvering, 293 U.S. 465, 469 (1935). Similarly, the Board was cognizant of the fact that every
properly incorporated entity that has a business purpose or is engaged in business activity must be recognized for tax purposes. See *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 439 (1943). As the Board noted in *Syms*, “the degree of corporate purpose and activity required for the recognition of a corporation as a separate legal entity for tax purposes is extremely low.” *Syms*, Mass. ATB Findings of Fact and Reports at 2000-749 (citing *Strong v. Commissioner*, 66 T.C. 12 (T.C. 1976), aff’d, 553 F.2d 94 (2nd Cir. 1977)).

In the present appeals, there was no question that Holdings was legally a separate corporation from IDG. However, the sham transaction analysis turns not on the legality of a particular corporate entity, but on the economic substance of the entity’s business transactions. *The TJX Companies*, Mass. ATB Findings of Fact and Reports at 2007-848, 849; *Sherwin-Williams*, 438 Mass. at 86.

The transfers at issue in the present appeals differed slightly from those in *Syms* and *Sherwin-Williams*. In those appeals, the transactions at issue involved the transfer and license-back of trademarks between a parent corporation and its wholly-owned subsidiaries, and the assessments at issue rested on the deductibility of royalty payments made by the parent corporation to the subsidiaries. In the
present appeals, the parent corporation, IDG, purported to transfer the World Logo and transferred the related license agreements to Holdings, but did not license the World Logo back from Holdings. Rather, Holdings received royalty payments from IDG’s foreign subsidiaries for the use of the World Logo.

Despite these factual differences, the court’s analysis in *Sherwin-Williams* encompassed transactions much like those in the present appeals:

> In the context of a business reorganization resulting in new corporate entities owning or carrying on a portion of the business previously held or conducted by the taxpayer, this requires inquiry into whether the new entities are “viable,” that is, “formed for a substantial business purpose or actually engaging in substantive business activity.”

*Id.* at 85-86 (internal citations omitted). Further, as established in *The TJX Companies*, sham transactions need not involve the creation of new corporate entities, but can occur following transfers to existing corporations. *The TJX Companies*, Mass. ATB Findings of Fact and Reports at 2007-805,806.

After applying the above inquiry to the particular facts of *Sherwin-Williams*, the court found that the transfer and license-back arrangements “[were] a product
and intended part of a business reorganization, and their economic substance and business purpose must be assessed not in the narrow confines of the specific transactions between the parent and the subsidiaries, but in the broader context of the operation of the resultant business."  *Id.* at 86 (citing *Northern Ind. Pub. Serv. v. Commissioner of Internal Revenue*, 115 F.3d 506, 512 (7th Cir. 1997)).  The court then “conclud[ed] that the reorganization, including the transfer and licensing back of the marks, had economic substance in that it resulted in the creation of viable business entities engaging in substantive business activity.”  *Sherwin-Williams*, 438 Mass. at 86.

In particular, the court relied on the following to determine that the subsidiaries in *Sherwin-Williams* were engaged in substantive business activity: “[l]egal title and physical possession of the marks passed from Sherwin-Williams to the subsidiaries as did the benefits and burdens of owning the marks”; “[t]he subsidiaries entered into genuine obligations with unrelated third parties for use of the marks”; “[t]he subsidiaries received royalties, which they invested with unrelated third parties to earn additional income for their businesses”; and “[t]he subsidiaries incurred and paid substantial liabilities to
unrelated third parties and to Sherwin-Williams to maintain, manage, and defend the marks.” *Id.*

Focusing on these factors in the present appeals, the Board found and ruled that the transfers at issue were sham transactions which lacked economic substance and which served merely as a means to divert royalty income otherwise taxable in Massachusetts to Delaware.

**i. IDG Did Not Transfer the World Logo to Holdings**

Significant to the court in *Sherwin-Williams* was the fact that legal title and physical possession of the trademarks had passed from Sherwin-Williams to its subsidiaries. *Sherwin-Williams*, 438 Mass. at 86. The court drew upon this fact to conclude that the transactions at issue in that case were not sham transactions. In the present appeals, the appellants asserted that the World Logo was effectively transferred from IDG to Holdings on October 1, 1988 via the Executive Consent. However, that assertion is belied not only by the plain terms of that document, but by the evidence of record.

The Executive Consent stated that IDG was “authorized and directed to transfer the tradename ‘IDG’ and the IDG corporate logo to its wholly owned subsidiary, IDG Holdings, Inc...” and further “authorized and directed [IDG’s officers] to execute and deliver all documents, and
take all action, necessary or desirable to carry out said transfer.” (emphasis added). The Executive Consent recognized, by its own terms, that additional actions and documents were necessary to effectuate the actual transfer of the World Logo. However, no documents demonstrating such further actions were entered into evidence, and no witnesses offered testimony that any additional actions were ever taken. In fact, the appellants’ witnesses testified that they could recall no such additional action or document.

Moreover, the appellants’ assertion that IDG transferred the World Logo on October 1, 1988 through the Executive Consent was undercut by the fact that, on the very same day, IDG transferred the license agreements through a properly executed “Assignment of Logo Agreement.” No testimony or other explanation was offered as to why IDG executed a proper assignment agreement to effectuate the transfer of the license agreements but neglected to execute such a document for the transfer of the World Logo. The Board could infer from this discrepancy only that the World Logo was not transferred to Holdings on October 1, 1988.

In addition, the substantial evidence of record supported the conclusion that, at all times prior to and during the years at issue, IDG remained the owner of the
World Logo. There was no dispute that IDG, and not Holdings, first developed and owned the World Logo. IDG first used the World Logo in 1987, according to the USPTO. However, no transfer of the World Logo was recorded with the USPTO. Compare *Sherwin-Williams*, 438 Mass. at 76. Moreover, there was evidence entered into the record that IDG registered the World Logo in its own name in foreign jurisdictions during the years at issue.

Further, IDG continued to use the World Logo throughout the years at issue despite the fact that it did not enter into a license agreement with Holdings for its use or pay royalty fees to Holdings as its foreign subsidiaries did. On October 1, 1991, IDG even entered into a license agreement with its Hungarian subsidiary for the use of the World Logo; that license agreement stated that IDG was the owner of the World Logo.

Through the testimony of their expert witness, Ethan Horwitz, and in their post-hearing briefs, the appellants cited a leading trademark treatise for the proposition that the Executive Consent was legally sufficient to effectuate the transfer of the World Logo. Specifically, the appellants cited the following passage: “An assignment in writing is not necessary to pass common law rights in a trademark. If there is no documentary evidence of an
assignment, it may be proven by the clear and uncontradicted oral testimony of a person in a position to have actual knowledge.” 2 J. Thomas McCarthy, _McCarthy on Trademarks and Unfair Competition_ § 18:4, at 18-9 (Thomas West, 4th ed. 2006). The Board does not question Mr. Horwitz’s or Mr. McCarthy’s expertise in intellectual property law;²⁷ nevertheless, the fact is that the oral testimony offered in these appeals to prove the transfer of the World Logo was indeed contradicted by the evidence of record. Accordingly, the Board found and ruled that IDG did not transfer the World Logo to Holdings.

ii. IDG Retained the Benefits and Burdens of Owning the World Logo

The court in _Sherwin-Williams_ held that legal title and physical possession of the trademarks had passed from Sherwin-Williams to its subsidiaries. _Sherwin-Williams_ 438 Mass. at 86. Moreover, the court held that, beyond legal title and physical possession of the trademarks, the benefits and burdens of ownership of the trademarks – including the responsibility and expense for their maintenance and defense – had also passed to the subsidiaries. _Id._ at 81.

²⁷ The Board does note, however, that there was no evidence that IDG intended to pass merely common law rights to the World Logo to Holdings.
In contrast, the court found in *Syms* that “[a]ll of the work necessary to maintain and protect the marks continued to be done by the same New York City trademark law firm that had previously performed those services, and Syms (not [its wholly-owned subsidiary]) continued to pay all of the expenses attendant thereto.” *Syms*, 436 Mass. at 509. Mere paper title to the trademarks, rather than the benefits and burdens of owning them, had passed from Syms to its subsidiary, and accordingly the transfer was found to be a sham transaction. *Syms*, Mass. ATB Findings of Fact and Reports at 2000-739, aff’d, 436 Mass. 505. In the present appeals, even if IDG had actually transferred paper title to the World Logo to Holdings, the transfers at issue still lacked economic substance because IDG retained control over the World Logo and the benefits and burdens of its ownership.

As in *Syms*, throughout the years at issue, IDG retained the burdens of ownership of the World Logo. All of the trademark registration and maintenance duties with respect to the World Logo were performed by Miriam Karlin, a paralegal employed by IDG. Ms. Karlin was not compensated by Holdings for her work, nor did Holdings pay a fee to IDG for her services. Holdings did not incur any
legal fees or other costs for the registration, maintenance or defense of the World Logo.

Additionally, IDG enjoyed the many benefits of ownership of the World Logo throughout the years at issue. IDG exerted continuing control over the use of the World Logo by virtue of its Style and Idea Book, which directed its subsidiaries on how to use and display the World Logo. IDG freely used the World Logo for its own purposes, including on its letterhead, business cards and Corporate Values Plaque, despite not having entered into a license agreement with Holdings for the use of the World Logo and despite not paying any royalties to Holdings. On October 1, 1991, IDG even entered into a license agreement for the use of the World Logo with another subsidiary, despite having purportedly transferred the World Logo to Holdings in 1988.

In determining that the transactions had a practical economic effect beyond the creation of tax benefits, the court in Sherwin-Williams found that after the transfer of the trademarks, the parent company “no longer had the exclusive right to use the marks. Instead, it had nonexclusive and time-limited licenses to most, but not all of them.” Sherwin-Williams, 438 Mass. at 87. In contrast, IDG’s position with respect to the World Logo did not
change after the transfers at issue. It retained possession of the World Logo, continued to use the World Logo and continued paying the expenses of its management and maintenance. On this basis, the Board concluded that the transfers at issue had no “practical economic effects beyond the creation of... tax benefits.” *Id.* at 85.

iii. Holdings did not Engage in Substantive Business Activity

In concluding that the transactions in Sherwin-Williams resulted in “viable business entities engaging in substantive business activity,” the court emphasized the following facts:

[T]he subsidiaries entered into genuine obligations with unrelated third parties for use of the marks; [t]he subsidiaries received royalties, which they invested with unrelated third parties to earn additional income for their businesses; [and][t]he subsidiaries incurred and paid substantial liabilities to unrelated third parties and to Sherwin-Williams to maintain, manage, and defend the marks.

*Id.* at 86.

In the present appeals, there was no indication in the record that Holdings engaged in substantive business activity with third parties. As discussed above, Holdings did not engage in activities to maintain or defend the World Logo, nor did it incur liabilities for the management, maintenance, or defense of the World Logo.
Holdings did not license the World Logo to any third parties. Holdings did not even negotiate the license agreements from which it derived the royalty income at issue; the agreements had been fully executed prior to their transfer to Holdings.

Further, the Board found it difficult to fathom what substantive business activity Holdings could have engaged in without employees. Holdings had no employees during the years at issue, nor did it incur any expenses for salaries, in contrast to the subsidiaries in *Sherwin-Williams*, which had two salaried employees. *Sherwin-Williams*, 438 Mass. at 77.

There was conflicting evidence in the record as to whether Holdings leased office space during all of the periods at issue or only the later periods. Mr. Murphy testified that Holdings had leased office space beginning in 1988, and records of Holdings’ expenses for 1992 showed nominal amounts for rent. However, the only lease entered into evidence commenced in November of 1993. That lease was for an “unspecified portion” of an office suite from the Bank of Delaware for the minimal sum of $250 per month. Regardless of when Holdings first leased an office, the Board found this “office” to be a convenient contrivance, akin to the subsidiary in *Syms*, where the court found that
“[Syms’ subsidiary’s] corporate ‘office’ consisted of an address rented from [an accountant’s] Delaware accounting firm, for an annual fee of $1,200.” Syms, 436 Mass. at 509.

Unlike the subsidiaries in Sherwin-Williams, Holdings was not free to maximize its profits through strategic investments and re-investment in its business. Sherwin-Williams, 438 Mass. at 86, 88. Holdings’ investment policy required the vast majority of its funds to be invested in short-term instruments, such that IDG could have ready access to the funds at all times. There was no evidence that Holdings invested the royalty income it received to acquire additional assets or otherwise expand its business.

In Syms, the subsidiary held royalty payments received from the taxpayer “for a few weeks” before paying it back to the taxpayer, with interest and less expenses, as a tax-free dividend. Syms, 436 Mass. at 509. In The TJX Companies, nearly 90% of the royalties paid to the subsidiaries by the parent corporation were returned to the parent corporation in the form of loans. The TJX Companies, Mass. ATB Findings of Fact and Reports at 2007-824. Similarly, in Fleet Funding, Inc. and Fleet Funding II, Inc., the Board found that:
although some of the REITs’ receipts were temporarily invested on a short-term basis... the funds were eventually returned to Fleet.... There is simply no showing on this record that either [subsidiary] invested any receipts for their on-going business operations; rather, their receipts were returned to Fleet for its business operations.

Fleet Funding, Inc. and Fleet Funding II, Inc., Mass. ATB Findings of Fact and Reports at 2008-176. In contrast, a loan of $7 million made by one of the subsidiaries in Sherwin-Williams in the fourth quarter of 1991 was repaid in full, with interest, by the parent in the first quarter of 1992. Sherwin-Williams, 438 Mass. at 72.

The facts of the instant appeals more closely resembled those in Syms, The TJX Companies and Fleet Funding, Inc. and Fleet Funding II, Inc. than those in Sherwin-Williams. The royalty fees received by Holdings during the years at issue - which totaled $6,601,498 for 1992, $6,222,345 for 1993, and $6,667,655 for 1994 - were deposited into its bank account at the Bank of Delaware. When that bank account reached a certain level, funds were automatically swept from the account into an investment account which Holdings maintained with Merrill Lynch. Holdings’ investment policies required that not less than 80% of its total investments be made in instruments with a
maturity of no longer than 180 days, and at least half of that 80% was required to consist of instruments with a maturity of no longer than 49 days.

Evidence entered into the record showed that IDG had access to Holdings’ Merrill Lynch account during the years at issue and “borrowed” funds from that account without making full repayment. These purported loans from Holdings to IDG were interest-free and often made without the benefit of an instrument evidencing the debt. Further, the “loans” were made despite the fact that IDG had not repaid previous “loans” in full. Rather than re-investing the royalty income for its own business operations, Holdings returned the income via purported loans to IDG or merely held the income in its investment accounts so that IDG could “borrow” the funds as it pleased.

Further, Holdings did not even attempt to maximize its profits by charging interest on the purported loans which it advanced to IDG from its Merrill Lynch account. In sum, Holdings did not act as an independent, for-profit business, but served merely as a means to divert royalty income otherwise taxable in Massachusetts to Delaware.

On this record, the Board could not find that Holdings engaged in substantive business activity. Although IDG assigned the license agreements to Holdings,
IDG retained control of the World Logo and many other benefits and burdens of its ownership, including substantial amounts of the royalty income. Accordingly, the Board found and ruled that the transfers at issue had no practical economic effect beyond the avoidance of state tax.

The appellants’ attempt to characterize Holdings’ arrangements with the Bank of Delaware and its investment account with Merrill Lynch as business dealings with third parties was unpersuasive. In *Sherwin-Williams*, the court stated that “economic substance and business purpose must be assessed not in the narrow confines of the specific transactions between the parent and the subsidiaries, but in the broader context of the operation of the resultant business.” *Sherwin-Williams*, 438 Mass. at 86. Holdings’ business, ostensibly, was the licensing of an intangible – the World Logo – in exchange for a royalty fee. That is an activity in which it did not engage with any third parties. Holdings was not engaged in the business of renting portions of office suites or opening bank and investment accounts, and economic substance and business purpose cannot be assessed in that context. Moreover, construing something as simple as opening a bank account as substantive business activity “would make evasion of the

iv. **There was no Business Purpose for the Transfers at Issue**

Though the court in *Sherwin-Williams* "embrace[d] the reasoning of courts that have concluded that tax motivation is irrelevant where a business reorganization results in the creation of a viable business entity engaged in substantive business activity," having found that Holdings did not engage in substantive business activity, the Board considered it appropriate to inquire into the motivation behind the transfers. *Sherwin-Williams*, 438 Mass. at 89. The appellants set forth a series of non-tax purposes for the transfers at issue, but the Board found and ruled that the asserted purposes failed to justify those transfers and further were unsupported by the evidence of record.

The appellants suggested that the business purpose of the World Logo was to establish a unifying graphic element for IDG’s foreign affiliates. That is a legitimate reason for the creation of the World Logo, but it does not explain its purported transfer to Holdings. The World Logo would have served the very same purpose if it had been licensed to the foreign affiliates by IDG.
Further, the appellants suggested that the transactions at issue were undertaken in furtherance of IDG’s core value of decentralization, under which operating subsidiaries, rather than IDG, carried out active business operations. As discussed at length in the Findings of Fact above, the Board found that the operation of Holdings was contrary to and inconsistent with IDG’s decentralized method of doing business and therefore did not find this assertion credible. “One of the common threads in corporate tax shelter cases is that the transactions that have been scrutinized under the business purpose, economic substance, and sham transaction doctrines, and which have been found to be lacking, are transactions outside the ordinary course of the taxpayer’s business.” Business Purpose, Economic Substance, and Corporate Tax Shelters: Random Thoughts on Applying Judicial Doctrines to Interpret the Internal Revenue Code, Martin McMahon, Jr., 54 SMU L. Rev. 195, 206 (2001). Unlike IDG’s other subsidiaries, Holdings did not have its own employees, did not pay the mandatory headquarters fee and was not required to provide copious monthly and annual business reports to IDG. The Board found these anomalies indicative of the fact that Holdings was formed not to further substantive business
objectives, but purely for the purpose of state tax avoidance.

The appellants offered no documentary evidence contemporaneous with the transfers at issue or other evidence which supported their stated business purposes for those transactions and instead seem to have manufactured business purposes after the fact. As if to acknowledge these post-facto constructs, the appellants stated in their post-hearing brief “[a]t trial, IDG expressed several additional reasons for the transfer.” The Board found none of these scarcely-articulated “additional reasons” credible, however, as they were of the variety already rejected as valid business purposes by the court in *Syms* and *Sherwin-Williams*.

For example, the appellants asserted that isolation “from potential legal issues and liabilities” associated with the World Logo and the “protection of the mark in the event of bankruptcy” were business reasons for having Holdings own the World Logo rather than IDG. These purposes were nearly identical to those rejected as non-tax business purposes by the court in *Syms* and *Sherwin-Williams*, because, among other reasons, they did not and could not serve to accomplish the stated goals:
Syms proffered, and the board rejected, almost a dozen non-tax business purposes to support its claim that the transfer and license-back was not intended solely to avoid taxation. For example: Syms’ assertion that the transfer would protect the marks from claims of Syms's creditors was rejected by the board, because creditors could reach assets of Syms's wholly owned subsidiary; Syms's claim that the transfer would protect the marks from a hostile takeover was rejected, because Syms could only have achieved that goal by transferring the marks to an independent third party, and with eighty per cent of the stock controlled by the company founder, such a takeover was hypothetical at best.... While there may be many important business purposes attendant to the transfer and licensing back of intangible assets within corporate families, to be viable for the purposes claimed by Syms, they must be more than theoretical musings, concocted to provide faint cover for the creation of a tax deduction.


In the present appeals, the appellants presented no evidence that the transfers at issue advanced any of the asserted non-tax business purposes, nor any evidence that these issues were of concern to IDG at the time of the transfers. The Board found that the non-tax business purposes asserted by the appellants, such as insulation
from “potential legal issues and liabilities,” were nebulous at best and unsupported by the evidence.

In addition, the testimony of the Commissioner’s expert witness, Lee Bromberg, Esq., served to debunk the appellants’ asserted non-tax business purposes. Rather than insulate the World Logo from “potential legal issues and liabilities,” Mr. Bromberg testified that the transfers at issue could actually expose the World Logo to challenge under trademark law and therefore diminish its value and significance.

On the basis of all of the evidence, the Board found and ruled that the appellants’ asserted non-tax business purposes were “theoretical musings, concocted to provide faint cover” for IDG’s state tax avoidance plan rather than valid and credible business purposes. *Syms*, 436 Mass. at 513. The Board therefore found and ruled that the transfers at issue lacked a business purpose other than state tax avoidance. Because the Board found that there was no business purpose for the transfers at issue and that they had no practical economic effect beyond the creation of tax benefits, the Board found and ruled that the transfers at issue were sham transactions. Accordingly, the Board found and ruled that the Commissioner properly reallocated the royalty income at issue to IDG.
C. The Transfers at Issue Resulted in an Improper Assignment of Income


As with all substance-over-form analyses, the assignment-of-income doctrine invites inquiry into the substance of a transaction as well as the purpose behind it. However, as Justice Holmes noted in the seminal assignment of income case, Lucas v. Earl, “No distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.” Lucas v. Earl, 281 U.S. at 115. Therefore, regardless of the purpose for the transfer, a transaction in which a donor transfers the right to receive income flowing from an income-producing asset, in the absence of the transfer of
the underlying asset, cannot serve to shift the tax on that income from the donor.

Further, the assignment-of-income doctrine recognizes "the basic principle of the income tax law that it is a tax on income beneficially received." *Lucas v. Earl*, 281 U.S. at 112. Accordingly, transactions which involve the transfer of the right to receive income flowing from income-producing assets must be scrutinized to ensure that the income is in fact taxed to the beneficial, rather than nominal, recipient of the income.

As discussed at length above, the Board found that the World Logo was not transferred to Holdings. The parties further disputed whether the World Logo, or the license agreements themselves, constituted the income-producing property. However, the resolution of this issue does not depend on the mere identification of the income-producing property and its owner.

It is not enough to trace income to the property which is its true source, a matter which may become more metaphysical than legal. Nor is the tax problem with which we are concerned necessarily answered by the fact that such property, if it can be properly identified, has been assigned. The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him
as the recipient of the income for tax purposes.

Commissioner of Internal Revenue v. Sunnen, 333 U.S. 591, 604 (1948). The beneficial recipient of income for tax purposes, therefore, must be determined by examining the assignor’s power and control over the property and income following the transfer.

In Sunnen, the taxpayer, an owner of patents, entered into license agreements for the use of the patents with a company. The agreements were non-exclusive and could be terminated at any time by either party. The taxpayer owned 89% of the stock of the company and was its president and director. The taxpayer then assigned the license agreements to his wife and claimed he was no longer taxable on the royalty income received from the agreements. Sunnen, 333 U.S. at 593-94.

In finding that the taxpayer retained sufficient control over the royalty income flowing from the license agreements, the Court highlighted the taxpayer’s controlling position within the company, which gave him the ability to procure the cancellation of the contracts at any time and permitted him to direct and control the company’s production and sales policies, thereby potentially impeding the flow of royalties to his wife. Id. at 609. The Court
also relied on the fact that the taxpayer remained the owner of the underlying patents and could enter into license agreements with other entities, thereby diverting some of the royalty income from his wife. \textit{Id.}

Lastly, the Court emphasized the lack of a substantial change in the taxpayer’s economic status as a result of the assignments:

\begin{quote}
Despite the assignments, the license contracts and the royalty payments accruing thereunder remained within the taxpayer’s intimate family group. He was able to enjoy, at least indirectly, the benefits received by his wife. And when that fact is added to the legal controls which he retained over the contracts and the royalties, it can be fairly said that the taxpayer retained the substance of all of the rights which he had prior to the assignments.
\end{quote}

\textit{Id.} at 610.

As in \textit{Sunnen}, the Board found in the instant appeals that IDG remained the owner of the underlying intangible property – the World Logo – and in any event retained significant control over the license agreements and the royalty income flowing from them. After the transfer of the license agreements to Holdings, each party to the agreements was a wholly-controlled subsidiary of IDG. By virtue of its position as owner of the foreign subsidiaries and Holdings, IDG could direct either party to cancel the
license agreements, thereby ending the flow of royalty income to Holdings. Further, because the royalties were based on a percentage of revenue generated from sales of items displaying the World Logo, IDG’s ability to direct and control its foreign subsidiaries’ production and sales policies left IDG with significant control of the revenue stream flowing to Holdings.

Moreover, though each license agreement purported to grant the licensee exclusive use of the World Logo, the evidence revealed that the licenses were not exclusive. The uncontroverted evidence is that IDG entered into license agreements with multiple subsidiaries for the use of the World Logo on October 1, 1988, and continued to enter into such agreements thereafter. The record simply did not support a finding that IDG granted exclusive use of the World Logo to any of the licensees. Because the licenses were not exclusive, nothing prevented IDG from entering into additional agreements for the use of the World Logo by any entity and for any purpose, which could have great impact on the goodwill and value of the trademark.

In addition, IDG had access to and control over the royalty income received by Holdings. The evidence showed that IDG had access to Holdings’ investment accounts and
that IDG in fact “borrowed” liberally from those accounts, with no apparent restrictions. Similarly, IDG’s relationship to the World Logo did not change as a result of the transfers at issue. IDG continued to use the World Logo freely for its own purposes, despite the fact that it did not pay royalties to Holdings or enter into a license agreement for its use.

The appellants cited Sherwin-Williams for the proposition that the transfer of property to a wholly-owned corporation does not equate with a finding that the transferor-corporation retained substantial ownership rights over such property. The appellants specifically referenced the following passage:

[T]he fact that Sherwin-Williams owned the stock of the subsidiaries does not mean that the reorganization had no economic substance and or effect on its business. It no longer owned the marks. Instead, it owned stock in the companies that do. It no longer owned the exclusive right to use the marks. Instead, it had time-limited licenses to most but not all of them.

Sherwin-Williams, 438 Mass. at 87. That reference is inapoposite here for several reasons. First, the facts upon which the Court based its conclusion were absent from the instant appeals. Unlike Sherwin-Williams, IDG did retain possession of the trademark; unlike Sherwin-Williams, IDG
had no limitations on its ability to use the World Logo subsequent to the transfers at issue.

Although it is not dispositive as to whether there has been an improper assignment of income, sole stock ownership of all of the parties to a transaction certainly indicates an element of control over that transaction, which is why the assignment-of-income doctrine has “peculiar applicability” to transfers and assignments between related parties. \textit{Sunnen}, 333 U.S. at 605. Moreover, the Board did not base its finding on IDG’s stock ownership alone. Rather, IDG’s stock ownership was but one indication of its ability to direct and control the flow of royalty income. The overall record demonstrated the lack of change in IDG’s position with respect to the World Logo as well as its access to and control over the royalty income at issue. On the basis of all of these facts, the Board concluded that IDG retained substantial control over the World Logo, the license agreements, and the royalty income at issue and found that “[t]he transactions were simply a reallocation of income within the family group... which did not shift the incidence of income tax liability.” \textit{Id.} at 610. Accordingly, the Board found and ruled that it was proper to treat IDG as the beneficial recipient of the royalty income at issue and decided this issue for the appellee.
Finally, the Board rejected the appellants’ assertion that the Commissioner raised the assignment-of-income argument for the first time in her post-hearing brief, thereby imposing a substantial hardship on the appellants. The Letter of Determination issued by the Commissioner to the appellants, which was entered into evidence, articulated the assignment-of-income theory behind the assessments at issue, and that position was reiterated in the Commissioner’s Answer. Further, the appellants made no such complaint about the sham transaction argument mounted by the Commissioner. The assignment-of-income and sham transaction doctrines are but two aspects of the same underlying issue. The appellants were not deprived of an opportunity to present critical evidence or testimony, as the two doctrines rest on the same corpus of evidence. Contrast *Massachusetts Bay Lines, Inc.*, Mass. ATB Findings of Fact and Reports 2007-723, 731.

Moreover, had the Commissioner advanced only the sham transaction doctrine, the Board could have on its own considered and applied an assignment-of-income analysis to the facts. Both doctrines are judicially-created doctrines — sometimes referred to as the common law of tax — designed to ensure that “substance prevails over form.” *Spirit of Yankee, Inc.*, Mass. ATB Findings of Fact and Reports at
Accordingly, the Board found that the Commissioner properly and timely raised the assignment-of-income argument and therefore found the appellants’ assertion to be without merit.

III. The Commissioner Abated the Assessments against CW Publishing and CW Publishing Timely Filed its Petition

CW Publishing’s appeal included two distinct jurisdictional issues. The first was whether the Commissioner had abated the assessments at issue. CW Publishing contended that the Commissioner abated the assessments against CW Publishing and failed to make new assessments thereafter in accordance with the appropriate statutory requirements. The Board agreed.

The parties entered into the record substantial documentary evidence generated from DOR’s MASSTAX computer system. The MASSTAX records relating to CW Publishing’s abatement applications for the periods at issue reflected that the abatement applications were approved on March 24, 2003, prior to their subsequent denial on March 26, 2003. The Board found that the MASSTAX records were the best evidence of the sequence of events surrounding CW Publishing’s abatement determinations and accordingly determined that the Commissioner abated the assessments at issue on March 24, 2003.
The Commissioner in essence argued that the abatement approval reflected in MASSTAX should be ignored as it was entered in error and subsequently corrected. This argument stands in contrast to the position taken by the Commissioner in previous appeals. The Commissioner has, in past appeals, urged the Board to place significant reliance on records generated by the MASSTAX system, and the Board has done so. See Cape Cod Cruises, Inc., Mass. ATB Findings of Fact and Reports, 1998-355, 359; Joseph DiCato v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports, 2007-47, 51-52; Fleet Funding I, Inc. and Fleet Funding II, Inc., Mass. ATB Findings of Fact and Reports at 2008-122, 123-24. The Board found no reason to do otherwise in the instant appeals.

Indeed, the Board found that the facts of the instant appeals underscored the importance of the use of the MASSTAX system. Had Mr. Shields used the MASSTAX system to generate the NOAD, rather than his desktop computer, there would have been reliable, objective evidence of the date of his actions. Because Mr. Shields did not use the MASSTAX system, the Commissioner could only offer an explanation of events cobbled together from Mr. Shields’ admittedly hazy memory and other, less reliable evidence, including the somewhat contradictory MIRROR records. That explanation
was not the best evidence of the sequence of events surrounding CW Publishing’s abatement applications; the MASSTAX records were. The Board therefore found that the Commissioner abated the assessments against CW Publishing on March 24, 2003.

The Commissioner made several arguments on this issue, all of which were unavailing. The Commissioner pointed to the evidence of record which, in the Commissioner’s opinion, clearly indicated the Commissioner’s denial of CW Publishing’s abatement applications by a date no later than March 24, 2003. That evidence included the MIRROR records reflecting the March 20, 2003 entry by John Shields which stated that the applications were denied. Actions taken by Mr. Shields on that date, however, could not have effectuated a valid abatement denial.

General Laws c. 14, § 3 gives the Commissioner the authority to "authorize an official of the department to exercise in his name any power or perform in his name any duty which is or shall be assigned to him by any provision of law." See Commissioner of Revenue v. Demoulas Super Markets, Inc., 412 Mass. 181, 184 (1992). It is well established that the Commissioner may delegate her authority to perform certain actions to departmental employees. However, actions taken by departmental
employees without such delegated authority will be treated as a nullity. In Waban, Inc. d/b/a BJ's Wholesale Club v. Commissioner of Revenue, the Board ruled that the assessment at issue was invalid because there was insufficient evidence to establish that the DOR employee who signed an Instruction to Bill was an individual to whom the Commissioner had delegated the power to assess a tax. Waban, Inc. d/b/a BJ's Wholesale Club v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1997-472, 487; see also Interface Group–Nevada, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1997-931, 940.

By his own account, Mr. Shields was not authorized by the Commissioner to make final determinations on abatement applications involving an amount of tax in excess of $25,000. CW Publishing’s abatement application requested an abatement of nearly $200,000 in corporate excise, far outside the scope of Mr. Shields’ delegation of authority. Actions on CW Publishing’s abatement applications therefore required the approval of his supervisor, Alan Breen. The evidence reflected that Mr. Breen did not take any actions with respect to CW Publishing’s abatement applications until March 24, 2003. Actions taken by Mr. Shields prior to that date could not have effectuated a valid denial of

The Commissioner further argued that Mr. Breen approved the denial of the abatement in the MIRROR system on March 24, 2003 and that Mr. Shields mailed to CW Publishing a NOAD on that same day, making the abatement denial at least contemporaneous with, if not prior to, the March 24, 2003 abatement approval. However, the evidence indicated that Mr. Shields printed and generated the NOAD from his own desktop computer, and the MIRROR records, or even MASSTAX records, for that matter, could not and did not corroborate the date of Mr. Shields’ actions.

Moreover, the MIRROR records introduced into evidence were contradicted by the MASSTAX records. The MIRROR records indicated that Mr. Breen authorized the denial of the abatement applications in the MIRROR system on the same day that he authorized their approval in the MASSTAX system. As detailed above, the Board found that the MIRROR records offered little probative value as to the actual events surrounding CW Publishing’s abatement determinations. Although the Commissioner contended that an abatement denial was reflected in the MIRROR system, an
official denial notice was not and could not be generated by that system. In contrast, an abatement approval was recorded in the MASSTAX system, and an NAA was generated by that system.

Moreover, Mr. Breen did not testify at the hearing of these appeals, and the Board refused to speculate about the apparent conflict in his actions. “'Lengthy trials and board fact-finding' on the basis of conflicting testimony from subordinate DOR employees and inconclusive DOR procedural documents are unsuitable ways to piece together the Commissioner's intent." Unitrode Corporation v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 2000-79, 91 (quoting New York Times Company. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1997-742, 778). The Board therefore placed little weight on the MIRROR records and the testimony offered into evidence and found and ruled that the Commissioner abated the assessments against CW Publishing on March 24, 2003 as reflected in the MASSTAX records and on the NAA.

The Commissioner additionally argued that the March 24, 2003 abatement approval was the result of a mere clerical error, which did not effectuate an actual abatement, and which was immediately corrected by the subsequent abatement denial. Although the Board agrees
that the Commissioner may correct clerical and other
errors, it is how the Commissioner corrects such errors
that matters.

In *John S. Lane & Son, Inc. v. Commissioner of
Revenue*, the Commissioner revoked the taxpayer’s
classification as a manufacturing corporation for the tax
Commissioner’s determination in that case, made in 1981,
resulted in a deficiency assessment against the taxpayer
for each of those years. The taxpayer argued that the
Commissioner could not retroactively correct his
classification error, but the Court disagreed, holding
“that the Commissioner, under the provisions of
G.L. c. 62C, § 26(b), was entitled, after determining that
Lane was not a manufacturing corporation, to revoke that
classification and *assess* any corporate excise then legally
due to the Commonwealth.” *Id.* at 141 (emphasis added). In
that case, the Commissioner’s correction of his previous
error was made within the statutory time period for making
an assessment for each of the years at issue. The Court
found that the proper remedy for the Commissioner’s
previous error of granting manufacturing classification to
the taxpayer was to assess the tax properly due. Id. at 140.

In the instant appeals, the Commissioner had until April 22, 2003 to assess any deficiencies against CW Publishing. However, the Commissioner did not offer into the record an instruction to bill, Notice of Assessment or any other relevant assessing document showing that new assessments were made against CW Publishing after the assessments were abated on March 24, 2003.

"[W]hen the Commissioner has failed to issue a Notice of Assessment and Appellant has placed the occurrence of a valid assessment at issue, the Commissioner must come forward with evidence showing that he delegated his § 26(b) authority to an official, who duly performed the acts constituting the assessment." Interface-Group Nevada, Inc., Mass. ATB Findings of Fact and Reports at 1997-939, 940 (citing Waban, Inc. d/b/a BJ's Wholesale Club, Mass. ATB Findings of Fact and Reports at 1997-485). The Commissioner did not make new assessments following the abatement of the assessments on March 24, 2003, but instead, attempted to remedy the error by entering a denial in MASSTAX on March 26, 2003, after MASSTAX had issued an approval notice.
The evidence reflected that on March 25, 2003, DOR employee Richard Ray, whom Mr. Shields described as his subordinate, entered a note in the MASSTAX system indicating that he had “reprocessed the denial,” and the MASSTAX records showed an abatement denial on March 26, 2003. There was no evidence in the record that Mr. Ray had the authority to make assessments or deny abatements of corporate excise in any amount, and in particular there was no evidence that Mr. Ray had the authority to make assessments or deny abatements of corporate excise in the amount of the assessments against CW Publishing.

Moreover, the evidence showed that Mr. Shields’ delegation of authority extended to matters involving only $25,000 in corporate excise or less. The Board drew the reasonable inference that Mr. Ray did not have a delegation of authority greater than that of Mr. Shields, who was his supervisor, and accordingly, did not have the authority to make or deny the abatement of the assessments against CW Publishing. Mr. Ray’s computer entry, therefore, did not “bear the imprimatur” of a valid assessment, and the Board found and ruled that the Commissioner’s attempted remedy was improper. Interface-Group Nevada, Inc., Mass. ATB Findings of Fact and Reports at 1997-941. “An assessment not clothed in the Commissioner’s express, delegated
authority fails to conform to statute. And consistency requires that the Commissioner observe statute as closely in imposing a tax liability as must a taxpayer in seeking relief from that liability.” Id. (citing Commissioner of Revenue v. Pat’s Super Market, Inc., 387 Mass. 309, 311 (1982); Commissioner of Revenue v. Marr Scaffolding Co., Inc., 414 Mass. 489, 493 (1993)) (emphasis in the original). Accordingly, the Board found and ruled that there were no valid assessments remaining against CW Publishing for the years at issue following the abatement of the assessments on March 24, 2003. For this reason, as well as the reasons detailed in section IV, infra, the Board decided this appeal for CW Publishing.

The second jurisdictional issue was whether CW Publishing timely filed its appeal with the Board. General Laws c. 62C, § 39 (“§ 39”), in relevant part, provides:

Any person aggrieved by the refusal of the commissioner to abate or to refund any tax, in whole or in part, whether such refusal results from the denial of an abatement application made under section 36 or section 37, may appeal therefrom, within 60 days after the date of notice of the decision of the commissioner...

The Commissioner alleged that the March 24, 2003 and April 14, 2003 abatement denials were effective and that CW
Publishing did not timely file its Petition with the Board on July 24, 2003, because that date was more than sixty days beyond the date of both NOADs. CW Publishing countered that, regardless of when the NOAD was first issued, it did not receive a copy until July 8, 2003.

The evidence revealed that the abatement applications for all of the appellants were filed together, on March 3, 2003, and signed by the same individuals, Jayne Enos of IDG and George M. Locarno, Esq. The Commissioner issued an abatement denial dated March 24, 2003 to IDC and an abatement denial dated April 14, 2003 to World Expo, and neither World Expo nor IDC denied receiving those notices.

IDC and World Expo promptly filed their Petitions, on May 21, 2003 and June 6, 2003, respectively. Those Petitions were signed by Attorney William Halmkin, the same person who signed the Petition for CW Publishing. Because the filings for all of the appellants were made by the same individuals, and because IDC and World Expo promptly filed Petitions upon receiving the NOADs, the Board drew the inference that CW Publishing did not receive an NOAD in March or April of 2003. Conversely, CW Publishing filed its Petition on July 24, 2003, just sixteen days after receiving a copy of the NOAD via facsimile on July 8, 2003. This prompt filing was consistent with the filings made by
IDC and World Expo upon learning of their abatement denials, which were also handled by Mr. Halmkin.

Statutes which grant appeal rights, such as § 39 and G.L. c. 62C, § 37, are drafted so as to establish bright-line rules for taxpayers' appeal rights. In the case of § 39, one bright-line is the sixty-day limitation for filing a Petition with the Board following a NOAD. Though the statutory language is not specific as to whether it is the date of issuance or the date of receipt of the NOAD that triggers the sixty-day period, "[i]t is contrary to notions of fairness and common sense to assume that the Legislature intended a taxpayer to be accountable for failure to act in timely manner on notice that was never received." SCA Disposal Services of New England, Inc. v. State Tax Commission, 375 Mass. 338, 341 (1978).

Moreover, "statutes embodying procedural requirements should be construed, when possible, to further the statutory scheme intended by the Legislature without creating snares for the unwary." Id. at 341 (quoting Becton, Dickinson & Co. v. State Tax Comm'n, 374 Mass. 230, 233 (1978)). The statutory scheme intended by the Legislature in § 39 was to afford taxpayers a reasonable period of time to file a Petition upon the denial of an abatement application. Holding a taxpayer to the sixty-day
time limitation when it is unaware of the abatement denial would not further this goal. See also RHI Holdings, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1998-375, aff’d, 51 Mass. App. Ct. 681 (2001) (ruling that the taxpayer did not receive adequate notice of the Commissioner’s determination until receiving an additional notice, some five months after having received an initial, defective notice of determination, and therefore timely filed its appeal by filing within sixty days of receipt of the later notice).

The Commissioner’s arguments on this point were unpersuasive. The Commissioner alleged that a finding for CW Publishing on this issue could encourage deceitful behavior from taxpayers. The Board was not persuaded that a finding for CW Publishing on this issue would lead to such a result. The Board based its finding on credible testimony and specific evidence in the record indicating that CW Publishing had not received an NOAD prior to July 8, 2003. A taxpayer who claims non-receipt of a notice, but who cannot present credible testimony or other reliable evidence of non-receipt, will not benefit from the Board’s ruling. See Cape Cod Cruises, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports at 1998-361, 362; Watjus Electric, Inc. v. Commissioner of Revenue,
Mass. ATB Findings of Fact and Reports 1993-139, 143; Peterson v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 1994-305, 310. Accordingly, because CW Publishing filed its Petition within sixty days of its receipt of the NOAD on July 8, 2003, the Board found and ruled that it had jurisdiction to hear and decide this appeal.

IV. The Apportionment Issue

A. The Commissioner is not Estopped from Making Adjustments to the Apportionment Formula Following the Approval of an Alternative Apportionment Method under § 42.

Taxpayers with taxable business income both inside and outside of the Commonwealth ordinarily calculate their Massachusetts income for tax purposes following the methods set forth in § 38. Taxpayers who believe that the apportionment provisions in § 38 would not reasonably approximate their net income derived from business activities carried on in the Commonwealth may apply to the Commissioner under § 42 to use an alternate apportionment methodology. Section 42 states in relevant part:

If the allocation and apportionment provisions of this chapter are not reasonably adapted to approximate the net income derived from business carried on within this commonwealth, a corporation may apply to the commissioner to have its income derived from business carried on within this commonwealth determined by a
method other than that set forth in section thirty-eight. Such application shall be made by attaching to its duly-filed return a statement of the reasons why the corporation believes that the allocation and apportionment provisions of this chapter are not reasonably adapted to approximate its net income derived from business carried on within this commonwealth and a description of the method of allocation sought by it. A corporation which so applies shall, upon receipt of a request therefor from the commissioner, file with the commissioner, under oath of its treasurer, a statement of such additional information as the commissioner may require.

G.L. c. 63, § 42.

The parties in the present appeals agree that IDC applied for and received permission to use an alternative apportionment methodology for its publishing subsidiaries under § 42. Specifically, IDC requested to apportion the income of its publishing subsidiaries using the method set forth in the 1993 proposed regulation, and the Commissioner approved that request. Subsequently, on audit, the Commissioner made adjustments to the sales factors of certain of IDC’s subsidiaries, including CW Publishing, because the auditor incorrectly determined that those subsidiaries had improperly omitted certain out-of-state sales from the numerator of the sales factor.

The appellants argued that the Commissioner’s approval of the § 42 application precluded the Commissioner from
making subsequent audit adjustments relating to the apportionment calculation. The Board disagreed.

General Laws c. 62C, § 24 gives the Commissioner the authority to “examine the books, papers, records and other data of the taxpayer,” for the purposes of verifying a return, while G.L. c. 62C, § 26 gives the Commissioner the authority to assess additional taxes where a return does not report the full amount of tax due. Information placed on a return from calculations made under § 38, or from an alternative formula approved under § 42, is just one item of information on a return which the Commissioner is authorized to review, and if necessary, adjust to appropriately capture the full amount of tax. Simply because the Commissioner has approved the use of an alternative apportionment methodology does not mean that the Commissioner cannot examine a taxpayer’s return to ensure that the methodology has been applied correctly. Nothing in the language of any of the relevant statutes suggests such a prohibition, and in fact, the Commissioner’s regulations expressly state the contrary.

830 CMR 63.42.1 is the Commissioner’s regulation on apportionment under § 42. Much like the statute, the regulation sets forth detailed and strict requirements for the application for and use of an alternative apportionment
methodology. Further, the regulation provides that the Commissioner may “determine the tax due and assess the tax,” and penalties, in the event that a taxpayer uses an alternative method of apportionment without first complying with the provisions of the regulation, “or if the method for which permission was granted has not been properly followed.” 830 CMR 64.42.1(8)(e). (emphasis added). The regulation clearly indicates that the Commissioner may audit the return to ensure that the approved apportionment formula has been correctly applied.

“The commissioner's position is entitled to some deference because the Legislature has delegated to the commissioner the responsibility of administering, interpreting, and enforcing the State tax laws, and resolving statutory ambiguity, or silence.” Macy’s East, Inc. v. Commissioner of Revenue, 441 Mass. 797, 806 (2005) (citing G. L. c. 14, § 6; First Fed. Sav. & Loan Association v. State Tax Commission, 372 Mass. 478, 485 (1977)). Moreover, the Board found the regulation to be consistent with the legislative intent of the statute. Section 42 was enacted to provide taxpayers with the opportunity to use a method of apportionment more suitable at approximating their income derived from business activity in Massachusetts. It was not meant to provide
taxpayers with carte blanche to make errors, omissions, or affirmative misstatements in the application of their apportionment formula.

In making adjustments to the numerator of the sales factor reported by CW Publishing, the Commissioner did not rescind or otherwise act contrary to her prior approval of IDC’s § 42 applications for alternative apportionment. Rather, the Commissioner merely acted to correct a perceived flaw in the application of that alternative methodology, and the Board found and ruled that the Commissioner was entitled to take such action. However, for the reasons discussed below in subsection (B), the Board found and ruled that the adjustments which the Commissioner made to the sales factor were improper, and ultimately decided this issue for appellant CW Publishing.

B. The Commissioner Incorrectly Applied the Sales Throwback Rule

As discussed above, the Board found and ruled that the Commissioner had in fact abated the assessments against CW Publishing and issued a decision for CW Publishing. However, even if the Commissioner had not abated the assessments, the Board found and ruled that CW Publishing was entitled to an abatement because it properly applied the alternative apportionment methodology which had been
approved by the Commissioner, and the Commissioner’s adjustments to the numerator of CW Publishing’s sales factor were improper.

The apportionment of income is “an attempt [to] equitably... tax multistate and multinational businesses engaged in activity in Massachusetts.” *W.R. Grace & Co. v. Commissioner of Revenue*, 378 Mass. 577, 584 (1979). In furtherance of this goal, Massachusetts has adopted the “‘commonly adopted formula measuring the taxpayer's values in the Commonwealth in relation to its values worldwide’... which is embodied in § 38.” *W.R. Grace & Co.*, 378 Mass. at 584-85 (quoting *Dow Chemical Co. v. Commissioner of Revenue*, 378 Mass. 254, 259 (1979)) (other citations omitted). Apportionment of income under § 38, with exceptions not here relevant, involves multiplying the taxpayer’s taxable net income by a fraction, the numerator of which includes property, payroll, and sales factors. The sales factor itself is a fraction, the numerator of which is the taxpayer’s sales in the Commonwealth and the denominator of which is the taxpayer’s total sales. G.L. c. 63, § 38. The computation of the sales factor therefore requires a determination of the sales properly sourced to Massachusetts.
Under the “throwback rule” contained in § 38(f), sales of tangible personal property\(^{28}\) are considered Massachusetts sales “if the corporation is not taxable in the state of the purchaser and the property was not sold by an agent or agencies chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the corporation outside this commonwealth.” G.L. c. 63, 38(f). The purpose of the throwback rule is to prevent income from falling into a “no man’s land” of taxation. See generally J. Hellerstein, State Taxation ¶ 9.17[1] (2006).

The 1993 proposed regulation adopted a throwback rule which closely resembled the throwback rule in § 38. Under the 1993 proposed regulation, the numerator of the sales factor was to include “Massachusetts ad revenues” and “Massachusetts customer list revenues,” as well as revenues from other sources, derived from business carried on in the Commonwealth. For the purpose of the 1993 proposed regulation, “Massachusetts ad revenues” and “Massachusetts customer list revenues” were determined by multiplying the taxpayer’s total ad revenue or customer list revenue by a fraction, the numerator of which was the number of

\(^{28}\) Under § 38(f), sales other than sales of tangible personal property are sourced according to the locale of the income-producing activity.
purchasers and subscribers of the publication in Massachusetts and the denominator of which was the number of purchasers and subscribers of the publication everywhere.

The 1993 proposed regulation further indicated that, for the computation of the sales factor, the “Massachusetts ad revenues” and “Massachusetts customer list revenues” included the advertising and customer list revenues from states in which the publisher is not taxable, if the publication or customer list was not “sold by an agent or agencies chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the publisher outside of Massachusetts.” 830 CMR 63.38.6(2)(c).

During the years at issue, CW Publishing calculated its sales factor by counting as Massachusetts customers those customers in Massachusetts as well those located in states within the purview of the Massachusetts regional sales office, which included Connecticut, Maine, Massachusetts, New Hampshire, New York, Pennsylvania, Rhode Island and Vermont. The auditor made adjustments to CW Publishing’s sales factor because he concluded that CW Publishing failed to include in the numerator of the sales factor subscription revenues from sales in states
in which CW Publishing was not taxable and which were not made by agents connected with or sent out from outside of Massachusetts. In particular, the auditor included in the numerator of CW Publishing’s sales factor subscription revenues from each state in which CW Publishing did not have an office, which resulted in a considerable increase to CW Publishing’s Massachusetts taxable income. That adjustment, however, was erroneous, because CW Publishing was nevertheless taxable in those states by virtue of the activities of its salespeople, and sales from those states were therefore not includible in the numerator of the sales factor.

For the purpose of applying the throwback rule under Section 38, a corporation is taxable in another state if

in that state such corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject such corporation to a net income tax regardless of whether, in fact, the state does or does not.

G.L. c. 63, § 38(b). The voluntary filing of a tax return in a state is not, by itself, sufficient to establish that a taxpayer is taxable in that state. However, it is also “immaterial that the taxpayer may not have filed a tax return in a given state so long as the taxpayer’s
connections with the state provide a basis upon which the state might assert its jurisdiction to assess an income tax.” *Amray, Inc. v. Commissioner of Revenue*, Mass. ATB Findings of Fact and Reports 1986-98, 103; 830 CMR 63.38.1(5)(a)(2).

A state has “jurisdiction to tax” if

under the Constitution and laws of the United States, the taxpayer’s business activity could be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A state does not have such jurisdiction where, *inter alia*, the state is prohibited from imposing the tax by reason of the provisions of P.L. 86-272, 15 U.S.C. §§ 381-384. ("P.L. 86-272").

830 CMR 63.38.1(5)(b).

Foreign corporations are taxable in Massachusetts if they engage in any one of a broad variety of activities, including the buying, selling, or procuring of services or property, the employment of labor, or the exercise of any other “act, power, right, privilege or immunity” in the Commonwealth. G. L. c. 63, § 39. Applying that standard to the facts of the present appeals, the Board found and ruled that CW Publishing was taxable in the many states to which its advertising sales representatives travelled to solicit sales of advertising.
The testimony and documentary evidence entered into the record in these appeals established that sales representatives from CW Publishing’s eight regional sales offices, located in California, Georgia, Illinois, Massachusetts, New Jersey, Texas, Virginia and Washington, regularly travelled beyond those states to cover the sales territories within their designated regions. In particular, the evidence established that, during the years at issue, CW Publishing’s salespeople travelled to Alabama, Arizona, Colorado, Connecticut, Florida, Illinois, Iowa, Kansas, Kentucky, Maryland, Michigan, Minnesota, Missouri, Nebraska, Nevada, North Carolina, New York, Ohio, Oregon, Pennsylvania, South Carolina, and Utah to solicit advertising sales. The evidence showed that the salespeople made trips to these states on a regular basis, often staying for two to three days at a time. Accordingly, the Board found and ruled that CW Publishing’s employees engaged in business activities in those states sufficient to make CW Publishing taxable therein.

The Commissioner argued that CW Publishing was not taxable in states in which it had no sales office, but to which its employees travelled to sell advertising, because of the protection afforded by P.L. 86-272. P.L. 86-272 is a federal statute, enacted to protect companies from
becoming subject to tax in multiple states when their salespeople travel to those states merely for the solicitation of sales of tangible personal property. It prohibits a state from imposing a net income tax on a person if the only activity carried on in that state by or on behalf of such person is “the solicitation of orders... for sales of tangible personal property.” 15 U.S.C. § 381(a). The Commissioner argued that the activities of CW Publishing’s salespeople fell within the scope of P.L. 86-272, thereby insulating CW Publishing from becoming taxable in those states.

P.L. 86-272, however, applies expressly and strictly to the solicitation of sales of tangible personal property. Advertising is intangible property, not tangible personal property, and the solicitation of advertising sales does not fall within the scope of P.L. 86-272. See Boston Professional Hockey Association v. Commissioner of Revenue, 443 Mass. 276, 292 (2005) (affirming the Board’s finding that advertising revenues derive from intangible property); See also May Broadcasting Company v. State Tax Commissioner, 241 Neb. 660, 672 (1992) (holding that the sale of advertising is the sale of an intangible product).

The Commissioner also argued that because the proposed regulations addressed the throwback of only advertising and
customer list revenues, subscription sales revenue must be sourced according the provisions of § 38(f), rather than the throwback rules contained in the proposed regulations. The Commissioner further argued that, following the throwback rules under § 38(f), the subscription revenue at issue was properly thrown back to Massachusetts because it was not generated by agents situated at, connected with, or sent out from an office outside of Massachusetts. However, under both the proposed regulation and under § 38(f), sales cannot be thrown back to Massachusetts if the taxpayer is taxable in the state of sale. Because the Board found and ruled that CW Publishing was taxable in the states in which the subscription revenue at issue was generated, the distinction between the two provisions was irrelevant.

On the basis of these facts, the Board found and ruled that CW Publishing was taxable in many states beyond those in which it had sales offices and that the Commissioner improperly included subscription revenue from those states in CW Publishing’s sales factor. Accordingly, the Board decided this issue for appellant CW Publishing.

V. World Expo Failed to Meet its Burden of Proof

Appellant World Expo appealed from the Commissioner’s refusal to abate corporate excise for the World Expo years at issue, alleging in its Petition that the Commissioner
improperly adjusted the sales factor of its apportionment percentage by misallocating income from the sale of intangible property. However, World Expo offered no evidence at the hearing of these appeals. Further, in the appellants’ post-hearing brief, the only argument set forth relating to World Expo concerned the timeliness of the Commissioner’s assessments. As discussed in the Findings of Fact above, the Board found and ruled that this argument lacked any merit, as the evidence established that the Commissioner’s assessments against each of the appellants were timely made.

The burden of proof is on the party seeking an abatement. *Staples*, 305 Mass. at 26. Because it failed to introduce any evidence, the Board found and ruled that World Expo did not meet its burden of proving its right to an abatement and for that reason issued a decision for the appellee in Docket No. C268725.

VI. CONCLUSION

In conclusion, on the basis of all of the evidence, the Board found and ruled that the Commissioner’s adjustments to IDG’s income under § 33 were improper, as IDG received fair compensation for the administrative services it provided to its subsidiaries. Following the amounts submitted by the parties under Rule 1.33, the Board
issued a decision for appellant IDC in Docket No. C267868 and ordered abatements of corporate excise in the following amounts: $253,300 for tax year 1992; $643,479 for tax year 1993; and $678,384 for tax year 1994, together with penalties and interest. However, the Board found and ruled that the transfer of the license agreements and purported transfer of the World Logo were sham transactions which resulted in an improper assignment of income and that the royalty income at issue was properly reallocated to IDG. IDC’s request for additional abatements relating to that issue was therefore denied.

In addition, the Board found and ruled that the Commissioner had abated the assessments against CW Publishing and that, following the abatements, there were no valid assessments remaining against CW Publishing for the years at issue.

The Board further found and ruled that CW Publishing nevertheless timely filed its Petition. Further, the Board found and ruled that although the Commissioner was not precluded from making adjustments to the apportionment calculation following the approval of an alternative apportionment formula under § 42, CW Publishing was entitled to the abatements because it properly applied the alternative apportionment methodology which had been
approved by the Commissioner and the Commissioner’s adjustments to the numerator of CW Publishing’s sales factor were therefore improper. Accordingly, the Board issued a decision for appellant CW Publishing in Docket No. C271245 and ordered abatements of corporate excise in the following amounts: $14,274 for tax year 1992; $82,028 for tax year 1993; and $100,217 for tax year 1994, together with penalties and interest.

Lastly, because appellant World Expo failed to offer any evidence into the record, the Board found and ruled that it did not meet its burden of proving its right to an abatement and accordingly issued a decision for the appellee in Docket No. C268725.

THE APPELLATE TAX BOARD

By: ___________________________________________________________________

Frank J. Scharaffa, Commissioner