USE OF THE DELAWARE INVESTMENT HOLDING COMPANY FOR INTELLECTUAL PROPERTY ASSETS

A Faculty Advised Project
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of the
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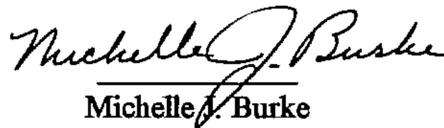
in partial fulfillment of the requirements for the
Master of Intellectual Property Degree

by:



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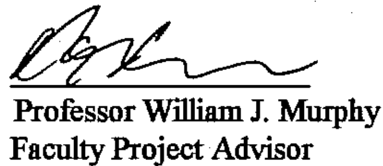
Approved: 

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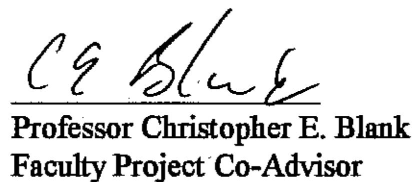

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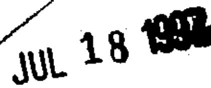
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ABSTRACT

Intellectual property assets are now being used in a variety of ways other than their traditional manufacturing or production uses. For many years, a generally accepted alternative use has been the reduction of a corporation's state tax liability through a Delaware Investment Holding Company (DIHC). By forming a DIHC, the parent company is able to gain a deduction for intellectual property royalty payments to a subsidiary holding company as a way of minimizing state income taxes.

However, in their never ending quest for more funding, states have targeted upon the DIHC tax strategy as a way of picking up missed income, and it is questionable whether this tax strategy will survive the onslaught. As a result, corporations may be forced to consider more creative uses for the DIHC concept.

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I. Introduction

The uses of intellectual property have spread beyond mere licensing and manufacturing into far more creative realms.[1] Recently, intellectual property portfolios have begun to be used by small inventors as a way to gain the funding necessary to maintain a patent infringement suit against a multi-million dollar company by allowing investors to invest in the outcome.[2] Companies, such as I.P. Reserve Corp., have sprung up that specialize in these investment opportunities.[3] As long as these companies have an ownership interest in the intellectual property assets, they are able to circumvent state laws that prevent the sharing of proceeds from suits against third parties, while the large damage awards given in patent law suits provide the investors with a high rate of return if there is a decision favorable to the inventor.[4]

Meanwhile, some corporations in the biotechnology industry have been using their

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[1] Intellectual property assets are now being used as a way to create funding for small inventors trying to bring patent infringement actions against large companies and for small start-up biotechnology companies.

[2] Linda Himelstein, *Investors Wanted - For Lawsuits*; BUSINESS WEEK, November 15, 1993 at 78.

[3] *Id.* Intellectual Property Reserve Corp., WBX Partners, Patent Protection Institute, and Patent Enforcement Fund invest in patent litigation. The risks and likelihood of recovery, the validity and value of the inventor's claims, and the resources of the target defendants are all evaluated prior to funding of the litigation. If a suit is successful, these companies receive up to 40% of the recovery amount.

[4] For examples of large damage awards, *see* Polaroid Corp. v. Eastman Kodak Co., 16 U.S.P.Q. 2d 1481 (D. Mass 1990), amended on reconsideration, 17 U.S.P.Q. 2d 1711 (D. Mass 1991), (damage award of $873,158,971 but was settled for $925 million in July 1991), Hughes Tool Co. v. Smith International, Inc., 229 U.S.P.Q. 81 (C.D. Cal 1986), vacated, 839 F.2d. 663, 5 U.S.P.Q. 2d 1686 (Fed. Cir. 1988) (damage award of $205 million), 3M v. Johnson & Johnson Orthopaedics, 22 U.S.P.Q. 2d. 1401 (D. Minn. 1991) (damage award of $107 million). Settlements prior to trial in patent infringement suits have been high as well, *see Minolta Settles Suit on Honeywell Patents*, N.Y. TIMES, March 5, 1992 at D4, (Minolta settled with Honeywell for $127,500,000).

intellectual property assets to gain financing through the formation of SWORDs and ARROWs.[5] SWORD (stock-warrant, off-balance-sheet research-and-development) is the term coined to indicate the creation of a new company to own a specific technology.[6] Research in the technology is contracted to the parent company, who retains a right to buy back the technology.[7] The term ARROW (asset-and-risk redeployment option with warrants) is used for a similar concept, except that the new company can combine the original technology with technology from other sources, and the parent retains the right to license any new products.[8] These strategies allow a biotech company to develop new products without the financial risk of providing its own research money.[9]

Corporations have also used their intellectual property portfolios as a way to limit state tax liability through the formation of a Delaware investment holding company.[10] However, this commonly known tax strategy has recently come under close scrutiny by state taxing authorities due to a recent South Carolina Supreme Court decision.[11] As a result, its potential as a tax

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[5] ALZA, Genzyme, Centocor, Genetics Institute, Immunex and Elan Corporation have set up SWORDs as a way to meet Research & Development costs without listing the costs on their books. Michael E. Solt, *SWORD Financing Of Innovation In The Biotechnology Industry*, FINANCIAL MANAGEMENT, Vol. 22, No. 2 (June 22, 1993) at 173.

[6] Ronald Rosenberg, *Biotech Firms Take Up Arms To Gain Research Financing*, THE BOSTON GLOBE, October 17, 1993, at 81.

[7] *Id.*

[8] *Id.*

[9] To date, these deals have produced a rate of return in the range of 20-33% on initial investment. *Financing Biotech Research With SPARCS & SWORDS*, BIOTECH BUSINESS, No.4, Vol. 7 (April 1994).

[10] A Delaware investment holding company is a Delaware company that is statutorily held exempt from Delaware corporate income tax due to the nature of its business activities, *see* text *infra* pp. 3-8.

[11] *See infra* pp.10-14 for a discussion of Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E. 2d. 13 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993).

saving device may need to be reexamined.

II. The Delaware Investment Holding Company Tax Strategy

A. What is a Delaware Investment Holding Company (DIHC)?

Under the Delaware Code, a business may operate free of Delaware's 8.7% state corporate income tax if its activities are confined to the maintenance and management of patents, patent applications, trademarks, trade names, and other intangible investments.[12] Each year, approximately 4500 companies file returns in order to qualify for exempt status under the statute[13], and are commonly referred to as Delaware Investment Holding Companies.

B. Set Up And Maintenance Of A DIHC

The procedures used in setting up and maintaining a DIHC are relatively straight forward. In order to gain the preferred tax status of an investment holding company, the company must apply for the exemption by submitting a one page form with the Delaware Division of Revenue.[14] During the application process, the company is allowed to request from the state a letter ruling on whether the activities of the corporation allow it to qualify as an investment holding company.[15]

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[12] DEL. CODE ANN. tit. 30, § 1902(b)(8) (1993).

[13] Telephone conversation with Mr. Ronald Kaminski of the Delaware Division of Revenue, Wilmington, DE (March 24, 1994). Corporations that use a DIHC as a holding company for their trademarks include Hershey Foods, PepsiCo and Merck. Mark D. Fefer, *States Eye Trademarks As Tax Trove*, FORTUNE, Vol. 129 (April 14, 1994) at 13.

[14] George T. Bell, Gordon V. Smith, Melvin Simensky, *A State Tax Strategy For Trademarks*, 81 TMR 445, 448 (1989).

[15] Telephone conversation with Mr. Ronald Kaminski at the Delaware Division of Revenue, Wilmington, DE (March 24, 1994).

Each year thereafter, the DIHC must file a two page information return to continue operating under the tax exempt status.[16] This insures that the company has not expanded its activities outside those authorized in the statute. Further, the DIHC must maintain a solid nexus with Delaware, and should be able to support this contention with adequate documentation.[17]

Under general taxation principles, contacts with another state would subject it to taxation in that state.[18] In order to demonstrate a nexus with Delaware, the company should have, at a minimum, a Delaware address, officers and employees (even if only on a part time basis) who perform all of their duties in Delaware, a Delaware bank account, and a Delaware phone number.[19] If possible, it is also recommended that general records and files be maintained and physically located at the Delaware office, and the intangible assets should be held at the office in Delaware or contained in a custody account with a Delaware trust company.[20]

C. Using A DIHC In Implementing A Corporate Tax Strategy

Once a holding company has been established, the parent operating company must transfer its intellectual property to the newly formed company in order to take advantage of the Delaware statute. The first step of this exchange is to determine the fair market value of the intellectual property assets that will be transferred.[21] This valuation needs to be objective and should be done

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[16] BELL et al, *supra* note 14 at 448.

[17] *Id.* at 449.

[18] *Id.*

[19] Ira H. Rosen, *Use of a Delaware Holding Company to Save State Income Taxes*, 20 TAX ADVISOR 180,181 (1989).

[20] BELL et al, *supra* note 14 at 449-450.

by a third party.[22] The transfer can then be accomplished either by a direct sale of the assets or by exchanging the assets for stock in the holding company.[23]

Since a direct sale of the assets would result in taxable gain which would be included in the parent corporation's gross income, the objective of reducing tax liability is best achieved by exchanging stock in the DIHC for the parent's intellectual property assets.[24] Under the federal tax laws, a transfer of property to a controlled corporation in exchange for stock is tax-free, as long as the transferor is in control of the transferee immediately after the exchange.[25] The holding company will qualify as a controlled corporation if the parent owns "at least 80% of the total combined voting power of all classes of [voting] stock and at least 80% of the total number of shares of all other classes of stock of the corporation".[26]

In this manner, the parent company can avoid having any gain included in its gross income, and will not incur any additional federal tax liability due to the formation of a DIHC. Further, by using this stock exchange method, the holding company would also avoid recognizing gain on the transfer.[27] Therefore, the holding company should be set up with the above stock limitations in mind so that the parent's tax liability on the conveyance can be minimized.

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21 *Id.* at 452.

22 Weston Anson, *Royalty Rates And Taxes: Intellectual Property And The Delaware Holding Company*, THE LICENSING JOURNAL (March 1992) at 9.

23 ROSEN, *supra* note 19, at 180.

24 *Id.* Gain on the sale of property is included in the gross income of the corporation. I.R.C. § 312 (b).

25 I.R.C. § 351(a) (1993). Tax Management Portfolios, Transfers to Controlled Corporations: Related Problems, Tax Management, Inc., Washington DC (1993).

26 I.R.C. § 368(c) (1993).

27 I.R.C. § 362(a) (1993).

Following the transfer of the assets, an estimation of a fair arm's length royalty rate on the assets is needed.[28] The most common approach to this analysis is to research royalty rates used in the industry for similar licenses.[29] Both federal and state taxing authorities require that comparable be used whenever possible when intercompany royalty rates are being used.[30] Although this is the rate that the parent corporations and any of its subsidiaries will pay in return for a license on intellectual property it originally owned itself, this must also be made as an objective determination.

License agreements between the holding company and the parent and any of its subsidiaries should then be drafted, signed, and implemented.[31] These agreements should also be treated, both in the drafting and implementation stage, as if they were between third parties, not a parent and its subsidiary.[32]

These royalty payments are deductible from the parent's income for state tax purposes, and it is this concept that is the vehicle for providing state tax savings to the parent company. Generally, a multistate company must allocate its taxable income to the various states in which it operates or owns property.[33] Typically, this allocation is based on an apportionment formula that

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28 ANSON, *supra* note 22, at 9.

29 The Grimes & Battersby Report, *Valuation Of Intellectual Property*, Spring 1993, at 2. There are four traditional methods used for intellectual property valuation. The "25% Rule" calculates a royalty at 25% of the gross profit (before taxes) from the operations in which the intellectual property is to be used. The market approach measures the present value of future benefits by considering how others in the market have valued similar property. The cost approach measures the future benefit by quantifying the amount of money that would be needed to replace the future service capability of the property. The income approach values the property based on the present worth of the net economic benefit to be received over the life of the property.

30 ANSON, *supra* note 22, at 9.

31 *Id.*

32 *Id.*

applies the proportion of the company's property, sales, or payroll within the state to its total earnings.[34] Since it is the parent's taxable income that is used for purposes of allocating income to the various states, the parent's deduction for royalty payments would result in reduced amount of total earnings to be used in the apportionment formula.

Since state tax rates on $250,000 of income can range from a low of 2.35% (Michigan) to a high of 12.25% (Pennsylvania), it is easy to see how royalty payments to a DIHC are instrumental in achieving substantial tax breaks.[35] However, one should note that the resulting lower state tax liability will result in a slightly increased federal tax liability for the parent company since the deduction is based on state income taxes paid will be lessened.[36]

The DIHC can transfer its income back to its parent company in one of two ways. The DIHC may make loans to its parent out of its royalty income, which would give the parent a deduction for state tax purposes based on interest paid to the holding company on the loan.[37] The parent would also be able to offset the interest income of the DIHC by the interest deduction of the parent when filing a consolidated federal return. Alternately, the income received by the DIHC may be transferred through stock dividends to the parent. Some states permit a deduction for some or all of the dividends. For federal tax purposes, this deduction would be 100% of the

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[33] Jessica J.M. Hagen, *Constitutional Limits On State Tax Jurisdiction*, 87 Colum. L. Rev. 1238, 1248 (1987).

[34] Lewis B. Kaden, *State Taxation of Multinational Corporations*, 32 Cath. U. L. Rev. 829, 832 (1983).

[35] State Tax Guide (CCH) ¶ 10-050 (1994).

[36] BELL et al, *supra* note 14 at 447 at note 6.

[37] Richard W. Genetelli, *Strategies To Minimize State And Local Taxes*, FINANCIAL EXECUTIVE Vol. 7, No. 1 (January 1991) at 51.

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dividends received by the parent.[38]

These holding companies are also exempt from Delaware's gross receipts tax and from business license fees.[39] Therefore, a holding company's only Delaware tax liability is an annual franchise tax that is imposed for the privilege of being a Delaware corporation and is based on the corporation's outstanding shares of stock.[40] If the holding company is set up with only 3,000 shares of capital stock, it will only be liable for the minimum franchise tax of $30 (and a $20 annual filing fee imposed on the franchise tax report).[41] Of course, there are also costs associated with the set-up, management and administration of the holding company.[42]

III. Limitations On The DIHC Tax Strategy

A. Legislative Restraints On A DIHC's Tax Savings

Statutes in several states, although not specifically aimed at DIHCs, effectively bar the tax benefits of a DIHC by concentrating its income inquiries on where the intellectual property is used. As early as 1991, Ohio passed a law stating that patent and copyright royalties, as well as technical assistance fees are allocable income to the extent that the licensee's activities which give rise to the payment take place in Ohio.[43] In Louisiana, royalties from the use of patents,

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38 I.R.C. § 243.

39 The Delaware Law of Corporations & Business Organizations, R. Franklin Balotti and Jesse A. Finkelstein, ¶ 20.11 Taxation of Delaware Corporations (1988).

40 ROSEN, *supra* note 19 at 180.

41 BELL et al, *supra* note 14 at 448.

42 ANSON, *supra* note 22 at 9.

43 [1994] State Tax Guide (CCH) ¶ 10-730. Janet Novak, *Money & Investing, Taxing Matters: Hot Pursuit*, FORBES (September 28, 1992) at 120.

trademarks, copyrights, trade secrets and other similar intangible rights are allocated to the state or states in which such rights are used.[44] Connecticut and Illinois also statutorily provide that royalties from the use of patents or copyrights within their borders should be apportioned to them as income.[45]

In the past, Massachusetts also proposed regulations aimed at income derived from the "use" of intellectual property. The proposal specifically defined the term "use" to mean "actual use, such as the use of patents or trade secrets in a manufacturing process, the physical reproduction of copyrighted material, or the retail display of a trademark or trade name".[46] However, under the proposed rule, the licensing income was only attributed to Massachusetts "if the licensee uses the property either solely in Massachusetts or more in Massachusetts than in any other state".[47]

Further, the requirement of some states that affiliated companies file combined returns also eliminates the tax benefit of using a DIHC.[48] Unlike states that apportion only the income reported by the affiliates of a multistate corporation doing business within the state, a state with a combined reporting system uses the income from all affiliates for apportionment.[49] A state combined reporting requirement operates in the same manner as the consolidated return for

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[44] [1994] State Tax Guide (CCH) ¶ 10-477.

[45] [1994] State Tax Guide (CCH) ¶ 10-297 and ¶ 10-402.

[46] Sam A. Mawn-Mahlau, *Massachusetts Proposed Apportionment Reg - No Surprises, Considerable Guidance*, 93 State Tax Notes 39-14 (March 1, 1993).

[47] *Id.*

[48] GENETELLI, *supra* note 37 at 51.

[49] Theodore V. Spangler, Jr., *Combined Reporting By A Unitary Business*, 93 State Tax Notes 155-21 (August 12, 1993).

federal tax purposes. The royalty income of the DIHC and the royalty expenses of the parent operating company will eliminate each other when determining tax liability.

Combined reporting can only be required of a "unitary business", which is generally defined as one or more related businesses between which there is a unity of ownership, operation, and use.[50] Identifying whether or not a subsidiary is unitary is often problematic.[51] In the case of a DIHC, it is likely that a state's taxing authority would consider the holding company to be part of a unitary business. The high percentage of DIHC stock owned by the parent, as well as the fact that the parent operating company and the DIHC would file a consolidated federal return in order to avoid the royalty transfers being included in any federal income tax calculations, are factors likely to indicate that the two companies are part of a unitary whole.

As of the end of 1993, combined reporting was required in Alaska, Arizona, California, Hawaii, Idaho, Illinois, Kansas, Minnesota, Nebraska, New Hampshire, Oregon, and Utah.[52]

B. The Geoffrey Decision

Due to the recent South Carolina Supreme Court decision, Geoffrey, Inc. v. South Carolina Tax Commission[53], the limitations in using a DIHC for tax benefit may be extended further. Geoffrey, Inc. is a Delaware investment holding company of Toys'R'Us, Inc. It owned several trademark and trade names, including the "Toys'R'Us" mark.[54] These marks had been

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50 *Id.* For an example of a state's statutory definition of "unitary business", *see* N.H. Rev. Stat. Ann. §77-A:1, XIV (1993).

51 *Id.*

52 [1994] State Tax Guide (CCH) ¶ 10-115.

53 437 S.E.2d. 13 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993).

licensed back to Toys'R'Us, Inc. for use in South Carolina and almost all other states in return for a percentage of net sales.[55] During the years in question, Toys'R'Us deducted the royalty payments made to Geoffrey, Inc., as a result of its South Carolina sales, from its South Carolina taxable income.[56] Although it first denied the deduction, the state tax commission later allowed it, but took the position that Geoffrey, Inc. was required to pay South Carolina income tax on the royalty income that it had been paid and the South Carolina corporate license fee.[57]

Geoffrey challenged the state tax commission's finding that its income was subject to tax under the laws of South Carolina.[58] Geoffrey also alleged that the imposition of these laws would violate Due Process and the Commerce Clause.[59] However, the trail court determined that

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[54] *Id.* at 15.

[55] *Id.* The license agreement between Toys'R'Us and Geoffrey requires that Geoffrey renew all trademark registrations and protect the trademarks from infringers. However, the legal services relating to trademark infringement are provided by outside counsel. State of South Carolina Before the South Carolina Tax Commission, slip op. (July 20, 1990).

[56] Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d. 13, 15 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993).

[57] *Id.* The South Carolina Tax Commission held that Geoffrey was "doing business" in South Carolina under the terms of §12-7-230, the relevant part of which states:

> "Every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of [South Carolina], whether or not such corporation be engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax ... the terms 'transacting', 'conducting' or 'doing business' as used in this section shall include the engaging in or transacting in any activity in [South Carolina] for the purpose of financial profit or gain."(Emphasis added)

Activities leading to the determination that Geoffrey was "doing business" within the state included the following factors: the Toys'R'Us trademark is "continually and systematically" used to "exploit South Carolina's retail markets", the trademark is displayed in and on all of the six Toys'R'Us retail locations found in the state, the trademark is used in all print and media advertising campaigns, and the fact that Geoffrey is required to defend the trademark against infringement in South Carolina. Geoffrey, Inc. v. South Carolina Tax Commission, No. 90-CP-23-3939, slip op. (S.C. 13th Cir. 1992).

[58] Geoffrey, Inc. v. South Carolina Tax Commission, No. 90-CP-23-3939, slip op. (S.C. 13th Cir. February 27, 1992).

[59] *Id.*

Geoffrey was carrying out activities for profit and gain within the meaning of South Carolina's tax laws.[60] The trial court further determined the Geoffrey's "activities in and contacts to South Carolina are of such a magnitude that South Carolina's taxing of a small portion of [Geoffrey's] net income does not violate Due Process or Interstate Commerce".[61]

On appeal to the state supreme court, Geoffrey again argued that the Due Process clause and the Commerce clause prevented South Carolina from taxing its royalty income.[62] Using the two-prong test was set out in Quill Corp. v. North Dakota[63], the court determined that the requirements of the Due Process Clause had been met.[64]

The court reasoned that by licensing its marks for use in specific states, Geoffrey "purposely sought the benefit of economic contact with those states" since a corporation may be taxed , even if it is not physically present in a state, if it "purposefully directed its activity at the state's economic forum".[65] The court continued by stating that Geoffrey "contemplated and purposefully sought" the economic benefit of South Carolina by licensing use of its mark there, especially since it was free to prohibit the licensing as it did with five other states.[66]

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60 *Id.*

61 *Id.*

62 Geoffrey, 437 S.E.2d. 13, 16 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993).

63 112 S.Ct. 1904, 1909-10 (1992). The Quill two-prong test requires: 1) there must be a minimum connection between the state and what it seeks to tax and 2) the income taxed by the state must be rationally related to the taxing state.

64 Geoffrey, 437 S.E.2d. 13, 16 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993). Quill was decided after the South Carolina trial court's ruling in Geoffrey.

65 *Id.*

66 *Id.* Toys'R'Us, Inc. was not licensed to use the mark in New York, Texas, Pennsylvania, Massachusetts, and New Jersey.

Despite Geoffrey's argument that its intangibles were located at its headquarters in Delaware, the court also found Geoffrey's intangible property to be present in South Carolina, and stated that this presence would also satisfy the minimum connections prong.[67] The second prong was deemed to have been met since the tax is "rationally related to [the] protections, benefits, and opportunities [provided by South Carolina]".[68] One rationally related benefit appears to be that the state provides services in the form of enforcement of trademarks to the DIHC.[69]

The court further reasoned that the commerce clause would not bar taxation in South Carolina since the licensing of its intangible property in the state and the derivation of income from these licenses is enough to establish a sufficient nexus with South Carolina.[70] The same analysis supporting its decision of the Due Process question would apply to this issue.[71]

The Supreme Court has refused to hear the an appeal on this case, so South Carolina remains free to tax Delaware holding companies on royalty income paid to them on uses of their trademarks and trade names. South Carolina's Department of Revenue, in an Information Letter, announced that it is reviewing the case to determine its application to other forms of intangible property.[72]

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67 *Id.*

68 *Id.* at 18.

69 Lee A. Sheppard, *Geoffrey: The Commerce Clause In The Information Age*, 94 State Tax Notes 2-13 (January 4, 1994).

70 Geoffrey, 437 S.E.2d. 13, 18 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993).

71 *Id.* at note 5.

72 *South Carolina Information Letter 93-20 On Impact Of Geoffrey Case*, 93 State Tax Notes 190-30 (October 1, 1993). "An Information Letter is a temporary document issued for the purpose of disseminating general tax information and to respond to technical questions from within the Department of Revenue which are NOT related to a specific set of facts." *Id.*

C. In The Wake Of The Geoffrey Decision

As a result of Geoffrey, two states have begun to draft their own legislation in an attempt to tax income received by a DIHC.[73] Florida has indicated that the holding in Geoffrey has "long been" its nexus policy.[74] To make this explicit, its Department of Revenue has proposed legislation that would tax a company if it engages in "selling or licensing the use of intangible property in Florida; for example, licensing the use of a trade name or trademark to a franchise".[75]

The Texas Comptroller's office has also announced an intent to follow South Carolina's lead, by providing that a corporation licensing intangibles, such as trade names, trademarks, patents, and copyrights, will be considered to have a nexus with Texas for purposes of its franchise tax.[76] A nexus sufficient for purposes of a franchise tax may also be sufficient for purposes of corporate income taxes.

Other states have started to re-evaluate their current tax statutes in light of the recent decision and denial of review by the U.S. Supreme Court.[77] The North Carolina Department of

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73 Within a few months of the U.S. Supreme Court's refusal to grant certiorari, Florida and Texas announced their intentions to follow the holding in Geoffrey and introduced new tax regulations that would make this possible.

74 William D. Townsend, Guilday Huey and Tucker Huey, *1993-94 In Taxes*, Florida Style, 94 State Tax Notes 6-9 (January 10, 1994).

75 Virginia A. Gates, *Coming To Grips With The Taxation Of High-Tech Intangibles*, 94 State Tax Notes 75-18 (April 19, 1994).

76 *Id.*

77 To date, North Carolina and Wisconsin have publicly declared that their pre-existing regulations will be construed to require a tax on royalty income from trademarks. However, commentators have started to theorize on the effect Geoffrey will have on the application of a state's pre-existing tax laws, *see generally*, Steven M. Bush, *Will Geoffrey Change Foreign Holding Company Income Treatment In Colorado*, 94 State Tax Notes 75-1 (April 19, 1994) (Discusses the application of Colorado's income tax to DIHC's).

Revenue has stated that it interprets its current rules to reach the same result as Geoffrey.[78] Its current rule states that "the owning of income-producing property in North Carolina including ... trademarks" subjects the owner to income tax, and the Department of Revenue has taken the view that the licensor owns the trademark in North Carolina by virtue of the licensee's use of the trademark in that state.[79]

The Department of Revenue for Wisconsin has also stated that licensing intangible assets in Wisconsin creates a nexus with Wisconsin under its current laws.[80] In fact, a nexus questionnaire routinely distributed by the state asks about any licensing activity in Wisconsin.[81] However, the state has yet to actively assert this proposition against a company.[82] New Hampshire has also informally advised corporate taxpayers that it intends to follow the ruling in Geoffrey[83].

As the number of states embracing the Geoffrey decision increases, many organizations are worried about the potentially devastating results.[84] If taken to its extreme, Geoffrey could

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78 Jack Cummings, *DOR's Latest 'Tar Heel Tax Review' Packs Surprises*, 94 State Tax Notes 40-13 (March 1, 1994).

79 *Id.*, quoting in part from Administrative Rules TI7:05C.0102.

80 Robert M. Fahrenback, *Wisconsin Nexus Project In Process*, 93 State Tax Notes 242-24 (December 17, 1993). The current law can be found at § 2.82 (4)(9) of the Wisconsin Administrative Code.

81 *Id.*

82 *Id.*

83 Richard L. Lieberman and Stewart Lipeless, *The Geoffrey Case: A Failed Attempt To Provide Content To The Economic Nexus Principle*, 94 State Tax Notes 50-13 (March 15, 1994).

84 The National Retail Federation, the Information Technology Association of America,Inc., the International Franchise Association, the Committee on State Taxation, the Tax Executives Institute, Inc., and the Ohio Chamber of Commerce filed amicus curiae briefs in support of Geoffrey's petition. Michael J. Semes, *A Discussion Of Geoffrey Inc.'s Petition For Writ of Certiorari, South Carolina's Response and Six Amicus Curiae Briefs*, 93 State Tax Notes 237-17 (December 10, 1993).

result in tax liability for celebrities who license out their names, companies that sell software containing licenses to the buyer for using the software, and authors who are paid royalties by a publisher from the sale of a book.[85]

IV. The Future Of The DIHC

A. What Uses Remain For DIHCs?

As can be seen by the prior section, the future of Delaware Holding Companies as tax shelters has begun to look bleak. Between current statutes and pending legislation, the states in which a DIHC can function in this way have been reduced. Further, the increased media attention given to the Geoffrey decision is likely to bring the DIHC tax strategy under the scrutiny of even more state taxing authorities.[86]

Despite the grim outlook, the DIHC should not yet be considered obsolete as a tax strategy. It is still too early to tell how many states will follow in South Carolina's footsteps, and state tax savings in even one high tax state that the parent operates in may be sufficient to warrant the formation of a DIHC.[87] Further, by remaining silent on the issues presented by Geoffrey, the

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[85] Linda Himelstein, *Intangible, Yes. Untaxable, No.*, BUSINESS WEEK (March 28, 1994) at 34. *Amicus Curiae Brief of Information Technology Association of America on Petition For Certiorari in Geoffrey Case*, 93 State Tax Notes 218-25 (November 12, 1993). *Geoffrey Inc. Petitions U.S. Supreme Court To Reverse South Carolina Decision*, 93 State Tax Notes 207-8 (October 27, 1993).

[86] *See generally,* Geoffrey A. Campbell, *It's No Game As Toys'R'Us Holding Company Fights Tax Case*, THE BOND BUYER (November 12, 1993) at 4, *Court Backs Tax Bite In Toys'R'Us Case*, The Associated Press, Nassau and Suffolk, Business (November 30, 1993) at 40, Virginia A. Gates, *Coming To Grips With The Taxation Of High-Tech Intangibles*, 94 State Tax Notes 75-18 (April 19, 1994), Mark D. Fefer, *More States Eye Trademarks As Tax Trove*, FORTUNE, Vol. 129, (April 14, 1994) at 13, Linda Himelstein, *Investors Wanted - For Lawsuits*, BUSINESS WEEK (November 15, 1993) at 78, Linda Himelstein, *Intangible, Yes. Untaxable, No.*, BUSINESS WEEK (March 28, 1994) at 34.

[87] For example, a company with a taxable income of $5 million dollars in a state with a 10% income tax rate would have a net tax savings in this one state of $33,000 using a DIHC. BELL, et al, *supra* note 14 at 447.

U.S. Supreme Court left open the opportunity to challenge these issues in other jurisdictions hoping to tax the use of intangibles.

Another option is to use the DIHC concept in yet unexplored territory. For example, if the DIHC were not controlled by the parent, it would no longer be subject to taxation in those states requiring combined reporting.[88] In this way, it might be useful is the area of biotechnology financing. By combining a SWORD or ARROW with the DIHC tax strategy, the parent may reduce its state tax liability as well as gain financing for its research and development programs.[89]

Generally, the first step in forming a SWORD or ARROW is to set up a subsidiary of a parent corporation for a defined area of technology. The parent then exclusively licenses its technology in the specified area to the subsidiary, and the subsidiary contracts the parent to do the actual research and development in that area.[90] The subsidiary then sells stock in an underwritten public offering that is usually in the form of a "unit" offering of both a share of the subsidiaries stock and a warrant to purchase a share of the parent's stock at a fixed price over a term of years, and the parent is granted an option to purchase the subsidiary's stock at a predetermined price that would provide investors with a premium over what they paid for the stock.[91] The subsidiary has a separate board and operates as a separate entity from the parent.[92] Since many biotechnology

[88] *See* text, *supra* pp.8-10.

[89] By paying forming the SWORD as a DIHC and paying royalties to it, the parent will be able to gain deductions in state tax liability due to the royalty payments while minimizing the state tax liability of the SWORD as well.

[90] William L. Respers, *Strategies For Exploiting Property Rights In Technology*, Patents, Copyrights, Trademarks, and Literacy Property Course Handbook Series: Technology Licensing and Litigation, March-April 1993. Usually, the parent contracts to do the research for an amount approximately equal to the sum of money raised in the financing. This is how the funding flows through to the biotech company forming the SWORD. *Financing Biotech Research With SPARCS & SWORDS*, BIOTECH BUSINESS, No. 4, Vol. 7 (April 1994).

[91] *Id.*

companies are "cash poor but technology rich",[93] SWORDs and ARROWs provide a way to obtain funding for further research.[94]

Incorporating a DIHC into the strategy would require a slight change is the usual procedure of setting up a SWORD. Instead of merely licensing the technology, the parent would need to assign the patents, patent applications, and trade secrets that cover the technology to the subsidiary. The fact that some of the technology assigned may be in the form of trade secrets should not cause problems since a strong argument could be made that, although not explicitly stated, trade secrets would fall under the "other intangible assets" terms in the Delaware statute.[95]

This transfer should be performed as an exchange for stock in the SWORD/DIHC. Subsequent to the transfer, stock of the DIHC could be sold in a public offering. As part of the R&D agreement, the parent would then obtain an exclusive license for all of the technology on which it contracts to do the research and development. The license agreement should include a clause granting the parent the right to sublicense any of the technology. This would allow the parent to further develop the technology but retain the right to license it out for manufacturing purposes at a later date.

The parent company would be able to deduct its royalty payment to the SWORD/DIHC

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[92] *Id.*

[93] *Id.*

[94] Other ways that biotechnology companies are obtaining funding include highly competitive federal grants such as the Small Business Technology Transfer Research Award, the Small Business Innovation Research grant program, and the Cooperative Research and Development Program, and state aid incentive programs such as those implemented in Colorado, Rhode Island, and Maryland. *So Many Firms, So Little Funding - Survival Strategies For Tough Times*, BIOTECHNOLOGY NEWSWATCH (October 18, 1993).

[95] *See* text, *supra* p.3.

from is income. Therefore, not only would it receive the cash benefit normally associated with SWORDs and ARROWs, but would get the additional cash benefit from reduced state taxes. Unlike the usual DIHC, the SWORD/DIHC would probably not be considered unitary with the parent due to its separate board, its operation as a separate entity, and the fact that the SWORD/DIHC stock would be owned by public investors. Since California, a state that is host to a growing biotech community, is a combined reporting state, there may be many biotech companies that could avail themselves of this tax saving strategy.[96]

B. Problems With Combining The DIHC And Financial Uses of Intellectual Property

The use of a DIHC in implementing a SWORD or ARROW is not without its own set of problems. The parent biotech company may not want to lose its ownership interest in intellectual property it developed to a company it does not control. Additionally, it is possible that the Internal Revenue Service may collapse the transfer transaction and the resell of the stock into one transaction for federal income tax purpose and require the parent to recognize gain on the transfer.[97]

Yet another hurdle may result from the Delaware statute itself. Contracting out research

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[96] However, it is possible that combined reporting states may follow South Carolina's lead in taxing the use of the intellectual property assets. New Hampshire, although a combined reporting state, has issued a statement that it will follow Geoffrey. Since royalty payments to a subsidiary would already be subject to tax under the combined reporting method, the statement seems to indicate that New Hampshire hopes to tax unrelated (non-unitary) companies receiving royalty income from intellectual property use. LIEBERMAN, et al., *supra* note 83.

[97] Generally, if there is an intent or obligation to resell the subsidiary's stock in the near future, the two separate transactions (the transfer of property in return for stock and the reselling of the stock) will be considered as one transaction. Thus, there will not be sufficient control of the subsidiary by the parent to qualify for the non-recognition of gain under I.R.C. § 351.

and development on technology may fall outside those activities "confined to the maintenance and management"[98] of intellectual property. Therefore, before setting up a DIHC for a SWORD or ARROW, it would be advisable to first seek a letter ruling from Delaware's Department of Revenue on whether or not the statue permits contracting out R&D on the assets.

Problems may also exist due to the Geoffrey decision and statutes apportioning income based on where the intellectual property is being used. The SWORD would still be required to pay income tax on the royalty income it receives in South Carolina and other states requiring that royalties from the use of intellectual property be allocated to the states in which the rights are being used.[99] Further, under Ohio law, the parent would have to allocate income to Ohio to the extent that its activities take place in Ohio.[100]

V. Conclusion

For years, Delaware investment holding companies have served as a way to minimize state tax payments. But in their never-ending quest for more funding, states have begun to seize upon the DIHC tax strategy as a way of picking up missed income. Foremost in this attack has been South Carolina, whose recent supreme court case, Geoffrey, Inc. v. South Carolina Tax Commission, has paved the way for other states to attempt to tax revenue earned by a DIHC. Further, those states requiring combined reporting already are able to tax the earnings of a DIHC. As a result of these developments, the use of a DIHC may not result in the substantial tax savings

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98 DEL. CODE ANN. tit. 30, § 1902(b)(8) (1993).

99 *See* text *supra* pp.14-16.

100 *See* text *supra* p.8.

that were once available.

This does not mean that the DIHC has outlived its usefulness. Without a ruling by the U.S. Supreme Court on Geoffrey, it is difficult to determine how far a reach the decision will have. Other state courts may not be as quick as South Carolina to broaden the reach of a state's taxation powers. Moreover, other situations may exist in which it is still possible to utilize the DIHC concept. One possible way of using a DIHC may be in the structuring of SWORDs and ARROWs by biotechnology companies.[101] Although this use may be restricted in South Carolina and other states who base their tax on the use of the intellectual property within their borders, it is an example of how new uses for the DIHC concept can still emerge.

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[101] *See* text, *supra* pp.16-20.

Appendix A:

DELAWARE CODE ANNOTATED
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*** THIS SECTION IS CURRENT THROUGH THE 1993 SUPPLEMENT ***

TITLE 30. STATE TAXES

CHAPTER 19. CORPORATION INCOME TAX

30 Del. C. § 1902 (1993)

§ 1902. Imposition of tax on corporations; exemptions

(a) Every domestic or foreign corporation that is not exempt under subsection (b) of this section shall annually pay a tax of 8.7 percent on its taxable income, computed in accordance with § 1903 of this title, which shall be deemed to be its net income derived from business activities carried on and property located within the State during the income year. Any receiver, referee, trustee, assignee or other fiduciary or any officer or agent appointed by any court who conducts the business of any corporation shall be subject to the tax imposed by this chapter in the same manner and to the same extent as if the business were conducted by the corporation.

(b) The following corporations shall be exempt from taxation under this chapter:

(1) Fraternal beneficiary societies, orders or associations:

a. Operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and

b. Providing for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents;

(2) Cemetery corporations and corporations organized or trusts created for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(3) Business leagues, chambers of commerce, fire companies, merchants' associations or boards of trade not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

(5) Clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

(6) A corporation maintaining a statutory corporate office in the State but not doing business within the State;

(7) Insurance companies paying taxes upon gross premiums to the Insurance Commissioner;

(8) Corporations whose activities within this State are confined to the maintenance and management of their intangible investments or of the intangible investments of corporations or business trusts registered as investment companies under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-l et seq.) and the collection and distribution of the income from such investments or from tangible property physically located outside this State. For purposes of this paragraph, "intangible investments" shall include, without limitation, investments in stocks, bonds, notes and other debt obligations (including debt obligations of affiliated corporations), patents, patent applications, trademarks, trade names and similar types of intangible assets; (Emphasis added).

(9) A corporation that is an S corporation for federal income tax purposes for any taxable year beginning on or after January 1, 1961;

(10) A corporation which qualifies as a domestic international sales corporation (DISC) under the provisions of subchapter N of Chapter 1 of the federal Internal Revenue Code 26 U.S.C.A. § 861 et seq. and which has in effect for the entire taxable year a valid election under federal law to be treated as a DISC. If a corporation makes such an election under federal law, each person who at any time is a shareholder of such corporation shall be subject to taxation under Chapter 11 or Chapter 19 of this title on the earnings and profits or taxable income of this DISC in the same manner as provided by federal law for all periods for which the election is effective;

(11) A corporation which qualifies as a foreign sales corporation (FSC) under subchapter N of Chapter 1 of the federal Internal Revenue Code 26 U.S.C. § 861 et seq. and which has in effect for the entire taxable year a valid election under federal law to be treated as a FSC and has and remains qualified under subparagraphs a. through c. of paragraph (12) hereof;

(12) A corporation which has as its primary purpose the provision of services to a foreign sales corporation(s) (FSC) as described in paragraph (11) of this subsection, and which meets the following qualifications for exemption from taxation under this chapter,

hereinafter referred to as a foreign sales service corporation (FSSC):

a. The FSC or FSSC must maintain, by itself or through an agent or a person under contract, an office within this State;

b. The FSC, by itself or through an agent or a person under contract or a FSSC on behalf of a FSC, has participated within this State in the solicitation (other than advertising) or the negotiation or the making of the contract for a FSC(s) derived from 1 or more transactions for the taxable year; and

c. The FSC or FSSC shall file, under rules and regulations prescribed by the Secretary of Finance, an information return stating its intention to qualify as a FSC or FSSC and an annual information return verifying compliance with the FSC or FSSC qualification rules for exemption.

The Secretary of Finance shall, on or before April 15 of each year, beginning April 15, 1986, make an annual report to the Governor and General Assembly of this State as to the revenue collected from and employment created by all FSC(s) and FSSC(s) qualifying or previously qualified under the rules and regulations prescribed by the Secretary of Finance.

A corporation shall be deemed to have as its primary purpose the provision of services to a FSC(s) if 80% or more of its gross receipts for the taxable year, as defined in § 2301(e) of this title, are derived from a FSC(s). An office, as used in this paragraph, shall mean a place for the transaction of business. Any other terms used in this paragraph shall have the same meanings as were used in a comparable context in the Internal Revenue Code of 1986 and amendments thereto [26 U.S.C. § 1 et seq.];

(13) Every export trading company as defined in § 7401 of Title 6;

(14) An entity that is a real estate mortgage investment conduit as defined in § 860D of the Internal Revenue Code of 1986 [26 U.S.C. § 860D], as amended.

HISTORY: 30 Del. C. 1953, § 1902; 51 Del. Laws, c. 298; 51 Del. Laws, c. 315, §§ 2, 3; 57 Del. Laws, c. 136, § 1; 57 Del. Laws, c. 737, § 2; 58 Del. Laws, c. 293, § 1; 58 Del. Laws, c. 396, § 1; 59 Del. Laws, c. 150, § 1; 61 Del. Laws, c. 76, § 1; 64 Del. Laws, c. 461, § 10; 65 Del. Laws, c. 155, § 2; 65 Del. Laws, c. 160, § 4; 66 Del. Laws, c. 267, § 2; 67 Del. Laws, c. 295, § 1; 67 Del. Laws, c. 408, §§ 4, 5; 68 Del. Laws, c. 423, § 1.

NOTES: REVISOR'S NOTE. --Section 1 of 65 Del. Laws, c. 155, provides: "This act may be referred to as "The International Trade Act of Delaware'." Section 6 of 65 Del. Laws, c. 155, provides: "This act shall become effective for taxable years beginning after Dec. 31, 1984." Section 1 of 65 Del. Laws, c. 160, provides: "This act may be referred to as "The Export Trading Company Act'." Section 6 of 65 Del. Laws, c. 160, provides: "This act shall become effective for taxable years beginning after June 30, 1985." Section 2 of 67 Del. Laws, c. 295, effective

July 5, 1990, provides: "This act shall become effective for taxable years beginning on or after July 1, 1990." Section 9 of 67 Del. Laws, c. 408, provides: "Sections 4 and 6 shall be effective upon enactment. The effectiveness of all other sections shall coincide with the effectiveness of respective provisions of the Federal Internal Revenue Code." The Governor signed 67 Del. Laws, c. 408 on July 18, 1990. The general effective date of the Internal Revenue Code of 1986 is Oct. 22, 1986.

Section 7 of 68 Del. Laws, c. 423, provides: "(a) Except as provided in subsection (b) of this section, if any provision of this act or the application thereof to any person or circumstance is held invalid, this act shall be considered invalid and void in its entirety from the date of its enactment, and the law shall be as if this act had never been enacted.

(b) Notwithstanding subsection (a) of this section, if any provision of this act or the application thereof to any person or circumstance is held invalid with respect only to a certain time or period of time, this act shall be considered invalid and void in its entirety under subsection (a) of this section only with respect to such time or period of time, but such invalidity shall not affect its validity with respect to other times or periods of time." Section 9 of 68 Del. Laws, c. 423, provides: "This act shall be effective for taxable years of S corporations beginning on or after Jan. 1, 1992."

EFFECT OF AMENDMENTS. --64 Del. Laws, c. 461, effective Aug. 13, 1984, added the last sentence in paragraph (8) of subsection (b).

65 Del. Laws, c. 155, added paragraphs (11) and (12) of subsection (b).

65 Del. Laws, c. 160, added paragraph (13) of subsection (b).

66 Del. Laws, c. 267, effective June 15, 1988, added subsection (b)(14).

67 Del. Laws, c. 295, effective July 5, 1990, inserted "or of the intangible investments of corporations or business trusts registered as investment companies under the Investment Company Act of 1940, as amended (15 U.S.C. § 80a-1 et seq.)" in (b)(8).

67 Del. Laws, c. 408, substituted ""1986" for "1954" in (b)(9) and (b)(12); and substituted "1961" for "1971" in (b)(9).

68 Del. Laws, c. 423, effective July 21, 1992, rewrote (b)(9).

FORM 1902 - AP

Appendix B:

STATE OF DELAWARE
DIVISION OF REVENUE
APPLICATION FOR EXEMPTION FROM CORPORATION INCOME TAX

SECTION 1902 (b) (8) HOLDING COMPANIES

PART 1

Name of Applicant

Address	Zip Code
Delaware Address if Different from Above	Zip Code

Date and State of Incorporation	Federal Employer Identification Number Required	Nature of Business

PART 2

Name and address of Delaware employees. (If additional space is needed, attach list.)

Name	Address

PART 3

Name and address of persons (individuals, corporations, etc.) owning more than 10% of the stock of corporation. (If additional space is needed, attach list.)

Name	Address

PART 4

Describe in detail below your operations in Delaware and list each type of intangible investment owned and all sources of income. **RECITING THE STATUTE DOES NOT CONSTITUTE AN ANSWER.** (If additional space is needed, please provide attachments.)

1. Will the corporation act as a general partner in a partnership? ____ YES ____ NO
   If yes, please describe the activities of the partnership.

2. Will the corporation participate in a joint venture? ____ YES ____ NO
   If yes, please describe the activities of the joint venture.

3. Will the corporation receive income from patents, royalties, copyrights, know-how, etc.? ____ YES ____ NO
   If yes, please disregard any services which will be performed by the coporation with regard to such intangibles.

4. Will the corporation engage in business outside of Delaware? ____ YES ____ NO
   If yes, please describe the activities.

Signature and Title

Date

RETURN TO: STATE OF DELAWARE, DIVISION OF REVENUE, 820 N. FRENCH STREET, WILMINGTON, DELAWARE 19801 ATTN: CONFEREE

Appendix C:

FORM 1902(b)
DELAWARE INFORMATION RETURN
HOLDING COMPANY/ INVESTMENT COMPANY

FOR OFFICE USE ONLY Rev. Code 042

This return for calendar year 19____. If not for calendar year, insert ending date of fiscal year______________ 19____

Name of Corporation	
Address	Zip Code
Delaware Address if Different from Above	Zip Code
Date and State of Incorporation	Federal Employer Identification Number

PART 1 – GENERAL INFORMATION

1. Name and address of compensated employees working in Delaware (do not include Directors).

Name	Address	Full-Time	Part-Time

2. Name, address, and F.E.I.N./S.S.N. of owners (individuals, corporations) of more than 10% of the stock of the corporation whose Delaware individual or corporate income tax liability exceeded $100,000 in any of the past three years.

Name	Address	E.I. or S.S. Number

PART II – QUESTIONS RELATING TO NON-EXEMPT ACTIVITIES

If the answer to any of the following is "yes," it would be an indication that the corporation is **NOT** exempt from Delaware corporate tax under § 1902(b), 30 Del. C. (If yes, please provide a brief description.)

	YES	NO
1. Did the corporation receive income from the following sources:		
a. Rental income from real property located within Delaware.	☐	☐
b. Rental income from tangible personal property located within Delaware.	☐	☐

2. Did the corporation provide in Delaware any of the services listed below for an unaffiliated entity or an affiliated entity other than as part of the corporation's meintenance and management of its tangible assets? (If yes, please provide a brief description.)

	YES	NO
a. Accounting and Bookkeeping	☐	☐
b. Legal	☐	☐
c. Consultation	☐	☐
d. Investment Advice	☐	☐
e. Collections	☐	☐
f. Management	☐	☐
g. Computer Services	☐	☐

INSTRUCTIONS FOR FORM 1092(B)
INFORMATION RETURN FOR HOLDING COMPANY/ INVESTMENT COMPANY

GENERAL INSTRUCTIONS

CORPORATIONS REQUIRED TO FILE RETURNS
Under 30 Del. C., §1904(g), an Annual Information Return may be required of each corporation claiming exemption from Delaware corporate income tax under 30 Del. C., §1902(b)(8) which provides an exemption for "Corporation whose activities within this State are confined to the maintenance and management of their intangible investments and the collection and distribution of the income from such investments or from tangible property physically located outside this State. For purposes of this paragraph, 'intangible investments' shall include, without limitation, investments in stocks, bonds, notes, and other debt obligations (including debt obligations of affiliated corporations), patents, patent applications, trademarks, trade names and similar types of intangible assets." Form 1902(b), Information Return for Holding Company/Investment Company, must be filed annually by corporations claiming exemption from corporate taxation under §1902(b)(8) of Title 30 of the Delaware Code.

PERIOD COVERED BY RETURN
The taxable year ending date of a corporation required to file Form 1902(b), Information Return, shall be the same as it is for purposes of computing its federal income tax.

WHEN TO FILE AND EXTENSIONS
Form 1902(b), Information Return, must be filed on or before the day of the fourth month following the end of the taxable year. A request for an automatic extension of six months to the Internal Revenue Service will automatically extend the filing date of the Delaware return by six months. If no federal extension was requested, an extension of time for filing may be made by a letter on or before the due date. Copies of extensions granted (Federal Form 7004 or Delaware Division of Revenue Approval Letter) must be attached to the return when filed. Please detach and mail Form 1902(b), Information Return, to the Division of Revenue, 820 N. French Street, P.O. Box 2044, Wilmington, Delaware 19899-2044.

PART I – GENERAL INFORMATION

LINE 1 – NAME AND ADDRESS OF COMPENSATED DELAWARE EMPLOYEES
Enter on Line 1 the names and addresses of individuals employed by the filing corporation within Delaware (do not include Directors). Please also indicate whether employed on a full or part time basis. If additional space is needed, please attach a separate schedule.

LINE 2 – NAME, ADDRESS AND IDENTIFYING NUMBER OF PERSONS OWNING MORE THAN 10% OF THE STOCK OF THE CORPORATION
Enter on Line 2 the name, address and Federal Employer Identification Number or Social Security Number of owners (individuals, partnership, or corporation) of more than 10% of the outstanding stock of the corporation whose Delaware individual or corporate income tax liability exceeded $100,000 in any of the past three years. If additional space is needed, please attach a separate schedule.

SPECIFIC INSTRUCTIONS

PART II – QUESTIONS RELATING TO NON-EXEMPT ACTIVITIES
If the answer to any of the following questions is yes, it would be an indication that the corporation is NOT exempt from Delaware corporate income tax under 30 Del. C., §1902(b)(8).

1. **Sources Of Income.** Did the corporation receive rental income from real property and/or tangible personal property located within Delaware? Please check appropriate box for each source of income and provide a description of the activities performed within Delaware for each "yes" box.

2. **Services Provided.** Did the corporation provide in Delaware any of the services listed for an unaffiliated entity or an affiliated entity other than as part of the corporation's maintenance and management of its intangible assets? Please check appropriate box for each service and provide a description of the service performed within Delaware for each "yes" box.

PART III – QUESTIONS RELATING TO EXEMPT ACTIVITIES
If the answer to any of the following is "yes," it would be an indication that the corporation is exempt from Delaware corporate income tax under §1902(b)(8), 30 Del. C.

1. **Sources Of Income Within Delaware.** Did the corporation directly or indirectly receive income from any one of the sources listed? Please check appropriate box for each source of income and for each "yes" response where the income received is in excess of $1 million, provide a description of the activity performed in Delaware in the space provided.

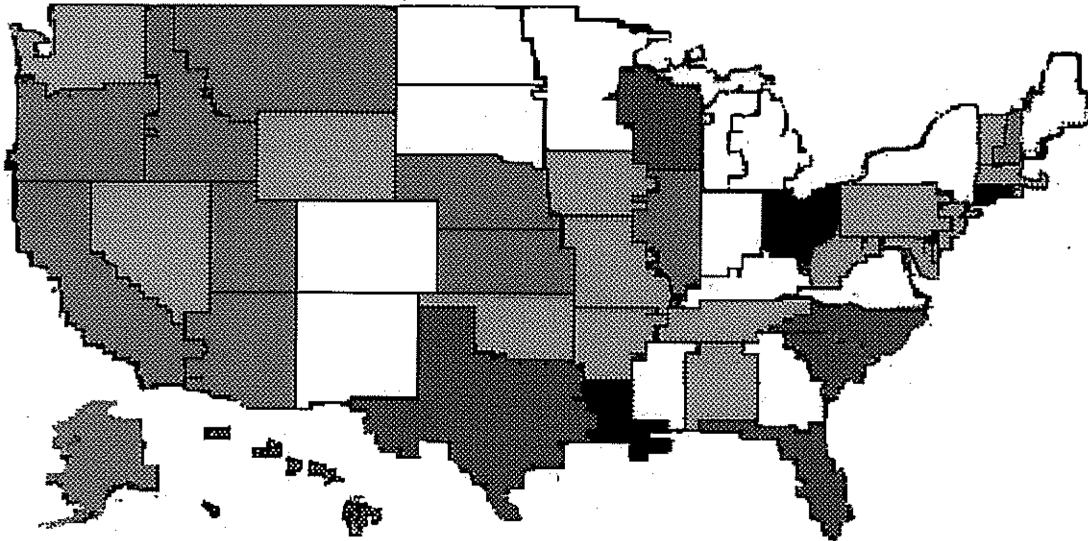
2. **Sources Of Income Without Delaware.** Is the corporation engaged in business activities outside Delaware other than those described in Question 1 above? If yes, please provide a brief description in the space provided.

PART IV – ADDITIONAL INFORMATION
Did the corporation have any sources of income other than the sources of income described in Parts II and III above? If yes, please describe the source of income and the activity in Delaware relating to it in the space provided.

SIGNATURE
Please sign and date this return indicating the title of the officer or designee signing this return. Detach Form 1902(b) and mail to the Division of Revenue, 820 N. French Street, P.O. Box 2044, Wilmington, Delaware 19899-2044.

Appendix D:

State Taxing Map



Black	States which had pre-existing statutes allocated intellectual property royalty payments to the state in which the rights are used.
Dark Grey	States which intend to follow the lead of the South Carolina Tax Commission.
Medium Grey	States in which combined reporting is <u>always</u> required of a unitary business.
Light Grey	States with unknown tax consequences.
White	States which may require combined reporting.