

IN THE CIRCUIT COURT OF BERKELEY COUNTY, WEST VIRGINIA

CONAGRA BRANDS, INC.,
Petitioner

JAN 13 2011

v.

CIVIL ACTION NO. 10-AA-02
Judge Christopher C. Wilkes

CRAIG A. GRIFFITH, WEST VIRGINIA STATE
TAX COMMISSIONER,
Respondent.

FINAL ORDER

This matter comes on for decision pursuant to the appeal by the Petitioner of an adverse decision of the West Virginia Office of Tax Appeals. And upon the briefs submitted by the parties and argument of counsel had on the 23rd day of November 2010, the Court is of the opinion to reverse the decision of the Administrative Law Judge and makes the follow findings of fact and conclusions of law.

This case turns on what constitutes "doing business" in West Virginia for purposes of the of the West Virginia corporation net income tax ("CNIT") and the business franchise tax ("BFT"). Specifically, the issue is whether the Petitioner's activities of holding, managing and licensing the use of its trademarks and trade names, by manufacturers of various consumer products, constituted doing business in West Virginia when the Petitioner's only connection with West Virginia was that some of those licensees, all of whom were domiciled outside of West Virginia, sold and distributed, at wholesale, their products with labels bearing the Petitioner's trademarks and trade names to other wholesalers and retailers situate in West Virginia.

In its administrative decision, that is the subject of this appeal, The West Virginia Office of Tax Appeals (OTA) held that the Petitioner's activities did constitute doing business in West Virginia, and that, therefore, the Petitioner was subject to the CNIT and BFT.

FINDINGS OF FACT¹

1. The Petitioner, ConAgra Brands, Inc., a Nebraska corporation, is a wholly-owned subsidiary of ConAgra Foods, Inc.

2. On January 2, 1997, ConAgra Foods, Inc. entered into an agreement with ConAgra Brands, Inc. whereby the former transferred its trademarks to the latter.

3. On January 2, 1997, ConAgra Foods, Inc. entered into an agreement with ConAgra Brands, Inc. whereby the former agreed to pay royalties to the latter for use of the trademarks transferred by the former to the latter.

4. Beginning on January 2, 1997, other affiliates of ConAgra Foods, Inc. transferred their trademarks to ConAgra Brands, Inc. by written agreements.

5. Beginning on January 2, 1997, ConAgra Brands, Inc. entered into agreements with other affiliates of ConAgra Foods, Inc. whereby those affiliates agreed to pay royalties to ConAgra Brands, Inc. for use of the trademarks transferred to ConAgra Brands, Inc. by those other affiliates of ConAgra Foods, Inc..

6. Beginning on January 2, 1997, ConAgra Brands, Inc. also acquired trademarks and trade names from unrelated entities.

7. ConAgra Brands, Inc. also licensed the use of its trademarks and trade names to unrelated third parties.

¹ The parties stipulated the facts numbered 1 through 21.

8. ConAgra Brands, Inc. pays all expenses in connection with its use of the trademarks and trade names including defending its trademarks and trade names against infringement and directing and overseeing national marketing of those trademarks and trade names by developing marketing strategies and purchasing the placement of advertisements with national media outlets.

9. ConAgra Brands, Inc. derived its income from the royalty payments it receives from the various licensees for their use of its trademarks and trade names including ConAgra Foods Inc., subsidiaries of ConAgra Foods, Inc. and unrelated third parties.

10. Prior to the creation of ConAgra Brands, Inc., ConAgra Foods, Inc. and the other subsidiaries of ConAgra Foods, Inc. incurred and paid the expenses associated with the use of their trademarks and trade names.

11. ConAgra Foods Inc. and affiliates deduct the royalties paid to ConAgra Brands, Inc. from gross income as an expense when determining their taxable income for state tax purposes.

12. To exercise their rights pursuant to their license agreements, the licensees first affix the trademarks and trade names, licensed to them by ConAgra Brands, Inc., to products the licensees manufacture in facilities located outside the State of West Virginia.

13. The licensees distributed their products bearing the licensed trademarks and trade names in West Virginia and throughout the United States.

14. The licensees sold or distributed products bearing the licensed trademarks and trade names, and other merchandise, to wholesalers and retailers located in West Virginia and throughout the United States.

15. The licensees provided services to their clients and customers in West Virginia and throughout the United States.

16. ConAgra Brands, Inc. did not maintain any inventory of merchandise or material for sale, distribution or manufacture in West Virginia.

17. ConAgra Brands, Inc. did not sell or distribute merchandise to its licensees, their customers or any other business entity in West Virginia.

18. ConAgra Brands, Inc. did not provide any services to its licensees, their customers or any other business entity in West Virginia.

19. ConAgra Brands, Inc. did not have any employees or agents in West Virginia.

20. ConAgra Brands, Inc. did not own or rent any offices, warehouses or other such facilities at locations in West Virginia.

21. ConAgra Brands, Inc. did not direct and/or dictate how the licensees distribute the products bearing the licensed trademarks or trade names.

22. ConAgra Brands, Inc. was created to centrally manage and provide for uniformity in brand image and brand presentation for the highly valued trademarks and trade names used by ConAgra Foods, Inc. and its subsidiaries.

23. The value in the trade names derived from the quality and taste of the finished food products to which the trade names were applied during production.

24. The royalty payments, ConAgra Brands, Inc. receives from its licensees, are measured by the volume of the licensees' sales of their products bearing the trademarks and trade names they licensed from ConAgra Brands, Inc.

25. Prior to the creation of ConAgra Brands, Inc., ConAgra Foods, Inc. and its subsidiaries operated as independent operating companies (IOC's), which made it difficult to maintain a uniform brand image and thereby protect the value of the various trademarks and trade names.

26. Due to the use of trademarks by multiple IOC's, the management of the marks was inconsistent, disjointed, and inefficient, so that, in many instances, the value of the various marks was damaged by the uncontrolled use of the trademarks by certain IOCs.

27. In other instances, rights to use certain trade names and trademarks in certain foreign countries were lost due to the failure to properly register the trade names and trademarks in those jurisdictions.

28. ConAgra Brands, Inc. was also formed to prevent such occurrences in the future, and to protect the intellectual property from infringement by third parties.

29. All manufacturing processes, utilized by the licensees to produce and to ensure the quality and taste of the finished products, occurred at the licensees' manufacturing facilities located outside of West Virginia, and the licensees did not operate retail stores in West Virginia.

30. ConAgra Brands, Inc. reported and paid income tax to states in which it owned or rented property, provided services or made sales to customers through its employees or agents.

31. Actions arising out of the licensing agreements between ConAgra Brands, Inc. and its licensees are governed by the laws of Nebraska.

32. On the basis of not having a connection with West Virginia by virtue of its activities, ConAgra Brands, Inc. did not file CNIT or BFT returns with the Respondent in any year.

33. In 2006, ConAgra Brands, Inc. was audited on behalf of the Respondent by an auditor for the Multistate Tax Commission (“MTC”) for the periods from June 1, 2000 to May 31, 2003 (the “periods in question”).

34. The MTC auditor asserted that ConAgra Brands, Inc. was subject to the CNIT for its income measured, in part, by the licensees’ sales of products in West Virginia during the periods in question.

35. The Respondent also asserted that ConAgra Brands, Inc. was subject to the BFT on its capital because its income was measured, in part, by its licensees’ sales of products in West Virginia during the periods in question.

CONCLUSIONS OF LAW

36. In appeals of this nature, the Court applies a clearly erroneous and abuse of discretion standard for review of the findings of the administrative body, unless the incorrect legal standard was applied to reach those findings. Frymier-Halloran v. Paige, 192 W.Va. 687, 458 S.E.2d 780 (1995), syl. pt. 3.

37. However, this Court reviews questions of statutory interpretation by the administrative agency on a *de novo* basis, and the clearly erroneous standard, otherwise applicable to proceedings such as this, does not protect factual findings made on the basis of incorrect legal standards. Id. at fn. 13.

38. Rather, where an appellant can demonstrate that an administrative decision in a contested case was based on a mistaken impression of the applicable legal principle, those findings “will be accorded diminished respect on appeal.” See id.

39. During the periods in question, the CNIT was imposed “on the West Virginia taxable income of every domestic or foreign corporation engaging in business in this State or

deriving income from property, activity or other sources in this State.” W.Va. Code §11-24-4(3). (Emphasis added)

40. For purposes of the CNIT, the term “engaging in business” or “doing business” means any activity of a corporation which enjoys the benefits and protection of government and laws in this state.” W.Va. Code §11-24-3a(11). (Emphasis added)

41. During the periods in question, the BFT was to be “collected from every domestic corporation, every corporation having its commercial domicile in this state, every foreign or domestic corporation owning or leasing real or tangible personal property located in this state or doing business in this state ...” W.Va. Code 11-23-6(a). (Emphasis added)

42. For purposes of the BFT, the term “doing business” means “any activity of a corporation ... which enjoys the benefits and protection of the government and laws of this state, ...” W.Va. Code §11-23-3(b)(8). (Emphasis added)

43. “Laws imposing a license or tax are strictly construed and when there is doubt as to the meaning of such laws they are construed in favor of the taxpayer and against the State.” Syl. pt. 1, State ex rel. Lambert v. Carman, 145 W.Va. 635, 116 S.E.2d 265 (1960). Accord Syl. Pt. 2, Baton Coal Co. v. Battle, 151 W.Va. 519, 153 S.E.2d 522 (1967) (“As a general rule, statutes imposing taxes are construed strictly against the taxing authority and liberally in favor of the taxpayer.”). Calhoun County Assessor v. Consolidated Gas Supply Corp., 178 W.Va. 230, 358 S.E.2d 791 (1987) (“Statutes governing the imposition of taxes are generally construed against the government and in favor of the taxpayer.”) The Coordinating Council For Independent Living, Inc v Palmer, 209 W.Va. 274, 546 S.E.2d 454.

44. In order to be subject to taxation by any state, a foreign corporation, or its activities, must have connections with that state which meet the requirements of the Due Process Clause, U.S. CONST. amend. XIV, and the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3.

45. A state's jurisdiction to tax under the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Quill Corp. v. North Dakota, 504 U.S. 298, 306, 112 S.Ct. 1904 (1974) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45, 74 S.Ct. 535, 98 L.Ed. 744 (1954)).

46. The extent of contacts by a foreign entity with a state, necessary to satisfy the Due Process Clause, is comparable to that needed to support a state court's jurisdiction over a defendant in a civil matter, and is met if the entity purposefully directs its activity into a jurisdiction; thus, the Due Process Clause does not require physical presence in the taxing state. Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

47. However, "the placement of a product into the stream of commerce, without more, is not an act of the defendant purposefully directed toward the forum State [A] defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum State." Asahi Metal Indus. Co. v. Superior Court of California, 480 U.S. 102, 112 (1987).

48. The Commerce Clause of the United States Constitution imposes a similar but more rigorous standard than that of Due Process; thus, "a tax may be consistent with due process and yet unduly burden interstate commerce." Quill Corp. v. North Dakota, 504 U.S. 298 at 313-14 n. 7 (1992).

49. The Framers of the United States Constitution intended, by the Commerce Clause, to prevent the States from retreating into economic isolation, or jeopardizing the welfare of the Nation as a whole, by putting discriminatory burdens on the free flow of goods across their borders, because, “to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.” Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 180, 115 S.Ct. 1331, 1336 (1995); Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 7, 106 S.Ct. 2369, 2372-2373 (1986), quoting Hughes v. Oklahoma, 441 U.S. 322, 325-326, 99 S.Ct. 1727, 1730-1731 (1979); see also The Federalist Nos. 42 (J. Madison), 7 (A. Hamilton), 11 (A. Hamilton).

50. State taxes unconstitutionally interfere with interstate commerce when they fail to meet each prong of a four-part test established in Complete Auto Transit, Inc. v. Brady, 430 U.S. at 274 at 279, 97 S.Ct. 1076 (1977).

51. That test requires that “the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.” Id.

52. Without violating the Due Process or Commerce Clauses, The Legislature may, for CNIT and BFT purposes, create a rebuttable statutory presumption of taxable substantial nexus with the State by an out-of-state company, without a physical presence in the State, based on a quantitative degree of that company’s systematic and continuous activity of soliciting and/or conducting business with customers in West Virginia. Tax Commissioner v. MBNA America Bank, N.A. 220 W.Va. 163, 640 S.E. 2d 226 (2006), cert. denied, 551 US 1141, 127 S. Ct. 2997 (2007).

53. With respect to the periods in question, the only such statutory presumptions of taxable substantial nexus created by the Legislature, for CNIT and BFT purposes, were for “financial organizations.” W.Va. Code §§11-23-5a(d) and 11-24-7b(d).

54. ConAgra Brands, Inc. is not a “financial organization” for CNIT or BFT purposes. W.Va. Code §§11-23-3(b)(13) and 11-24-3a(a)(14).

55. Even if arising, entirely or in part, from conduct occurring in West Virginia, actions to protect ConAgra Brands, Inc.’s rights in its trademarks and trade names would be brought exclusively in the courts of the United States under the provisions of the laws of the United States protecting such intellectual property. Title 17, United States Code, §§ 101 et seq.

56. When a foreign licensor, with no physical presence in a state, also has no privity with retailers in that state, but only with intermediary licensees which, in turn, have such privity, the licensor is not, by virtue of its privity with those intermediary licensees, subject to tax by that state on its income derived from such business relations with the licensees. Only A Name? Trademark Royalties, Nexus, and Taxing That Which Enriches, 22 Akron Tax Journal, 1 at 11.

57. Any person may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that path which will best pay the treasury; there is not even a patriotic duty to increase one’s taxes. Gregory v. Helvering, 69 F.2d 809 (2nd Cir. 1934).

58. As to the products, bearing labels imprinted with the trademarks and trade names licensed by ConAgra Brands’ to its licensees, when in West Virginia, either in the hands of those licensees, or the licensees’ retailer customers, neither the third-party suppliers of ingredients to the licensees for the products, nor the third-party suppliers of those labels, nor ConAgra Brands, Inc., have, purely by virtue of supplying those ingredients or labels, or licensing the use of those trademarks and trade names, the minimum, much less the substantial connection, with West

Michael E. Caryl, Esq. (WV Bar No. 662)
Floyd M. Sayre, III, Esq. (WV Bar No. 4342)
Bowles Rice McDavid Graff & Love, LLP
101 South Queen Street
Post Office Drawer 1419
Martinsburg, West Virginia 25402
(304) 264-4225

Charli Fulton, Esq.
Senior Assistant Attorney General
Office of the Attorney General
State Capitol Complex
Building 1, Room W-435
Charleston, WV 25305