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*** Electronically Filed ***
06/26/2009 8:00 AM

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2006-000240 06/25/2009

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT
S. Brown
Deputy

HOME DEPOT USA INC

MICHAEL G GALLOWAY

v.

ARIZONA STATE DEPARTMENT OF REVENUE

KIMBERLY J CYGAN

UNDER ADVISEMENT RULING

(Plaintiff's Motion For Partial Summary Judgment and Defendant's Cross-Motion For Partial Summary Judgment)

The Court revisits the question, which it first addressed in *R.R. Donnelley & Sons Co. v. Arizona State Dept. of Revenue*, TX2005-050288 (June 29, 2007), of whether the Department of Revenue may require combined returns for the licensor and the related user of trademarks. The Home Depot is a well-known seller of hardware and appliances. Its trademarks are prominently displayed throughout its stores and on many of the products it sells. However, the legal entity known as The Home Depot does not own any of those trademarks. Rather, they and related intellectual property are owned by Homer TLC, Inc., a wholly-owned subsidiary of The Home Depot, which licenses them almost exclusively to The Home Depot.

A.R.S. § 43-942 and § 43-947(C) give the Department of Revenue, in the first instance, the authority to require combined returns when necessary to accurately determine Arizona source income; such is the case here. This, however, is a distinct issue of law from whether the subsidiaries included in a single return with the parent are properly subject to unitary taxation. In determining which, if any, of the related companies are to be treated as unitary, the Court is guided by the analysis in *State ex rel. Arizona Dept. of Revenue v. Talley Industries, Inc.*, 182 Ariz. 17 (App. 1994). The Court of Appeals focused in that case on transfer pricing, and in particular the ability to establish, at least pro forma, arm's length prices for the intracompany

services provided. It found that in general, management functions can be accounted for by generally accepted accounting principles. *Id*. at 25. However, it recognized in some cases an "inability to establish fair arm's-length prices for goods transferred, or basic operational services rendered, between controlled branches or subsidiaries of an enterprise." *Id*. (quoting I Jerome R. Hellerstein and Walter Hellerstein, *State Taxation* ¶ 8.[4][b] (2d ed. 1993)).

As this Court observed in *R.R. Donnelley & Sons Co., supra*, trademarks are unique. "It has been recognized from the infancy of trademark law that a trademark has no cognizable existence distinct from the product to which it is attached. *See, e.g., Kidd v. Johnson*, 100 U.S. (10 Otto) 617, 620 (1879). It is an identifier of property rather than property in its own right. *TMT North America, Inc. v. Magic Touch GmbH*, 124 F.3d 876, 882 (7th Cir. 1997). 'A trademark symbolizes the public's confidence or "goodwill" in a particular product. However, it is no more than that, and is insignificant if separated from that confidence. Therefore, a trademark is not the subject of property except in connection with an existing business.' *Premier Dental Products Co. v. Darby Dental Supply Co., Inc.*, 794 F.2d 850, 853 (3d Cir. 1986) (internal footnote and quotation marks omitted)." *Id*. In a very real sense, the trademark is the product and the product is the trademark. It follows that, to put it in the context of *Talley*'s core function analysis, the core function of a seller of goods and services is indivisible from the core function of the formal owner of the trademarks associated with those goods and services: neither core function can be achieved in the absence of the other. This conclusion is strengthened by the absence of a free market in which a trademark can be bought and sold at an arm's-length price. By the very nature of a trademark, there is a monopsony: there can be only one buyer, who ultimately determines the price. Plaintiff has established that it obtained an independent appraisal which it asserts constitutes the equivalent of an arm's length price. But Homer and The Home Depot are interdependent to the extent that Homer has essentially no existence at all beyond its licensing of the Home Depot trademarks to The Home Depot, the only entity to which it legally can license them. *Talley* does not require the Department to accept the appraiser's estimate of what the market transfer price would be in an imaginary market in which such a transfer could be priced. In such circumstances, *Talley* allows the Department to require combined accounting. *Supra* at 25.

Therefore, IT IS ORDERED:

1. Plaintiff's Motion For Partial Summary Judgment is denied.

2. Defendant's Cross-Motion For Partial Summary Judgment is granted.