

The unitary group consists of the petitioner and its wholly owned FSC. An FSC is a foreign corporation by definition and, by its nature, it will always be unitary with its parent group.

Foreign Sales Corporations

The FSC provisions² were enacted by Congress in 1984 when the Domestic International Sales Corporation provisions were mostly repealed. An FSC is a foreign corporation set up by a U.S. parent to handle export activities.³ To satisfy foreign objections to the Domestic International Sales Corporations, an FSC must have a genuine foreign presence.⁴ Intercompany pricing must be at arm's length or equivalent. A portion of the foreign trade income of an FSC is exempt from U.S. tax.⁵ The rest is subject to U.S. tax,⁶ and both portions can be distributed to the parent with a 100% dividends received deduction,⁷ subject to foreign taxes on the FSC's income (which are not creditable⁸) and possible foreign withholding tax on the dividend. There are some complex exceptions to these rules. An FSC files Form 1120-FSC and reports the taxable portion of its income as "federal taxable income."

Idaho Law

Idaho employed worldwide combination as a matter of administrative practice for many years.⁹ The Idaho Supreme Court held this to be without statutory authority in the

² Internal Revenue Code (IRC) § 921 *et seq.*

³ IRC § 922. An FSC and a Domestic International Sales Corporation cannot coexist in the same "controlled group" of corporations. *Id.* (a)(1)(F).

⁴ IRC § 922.

⁵ IRC §§ 923 & 921 (income treated as not effectively connected with a U.S. trade or business).

⁶ IRC § 921(d)(income treated as effectively connected with a U.S. trade or business).

⁷ IRC § 245(c).

⁸ IRC § 901(h).

⁹ Constitutional authority for worldwide combined reporting is *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

1991 *Simplot* decision.¹⁰ As a result of *Simplot*, domestic combination (*i.e.*, combination including only unitary companies having federal taxable income and owned more than 50% by a common parent) was mandated. The Court's reasoning was that the tax base was defined as federal "taxable income," so the UDITPA reference to "business income" could not be expanded beyond federal taxable income to include the income of foreign corporations.¹¹ Thus, for 1992 and prior years, the "default" filing position for multistate corporate taxpayers was a domestic combination and only federal taxable income, with statutory modifications including adding back the dividends received deduction,¹² was subject to tax.

In 1993, the Legislature responded to *Simplot* by enacting detailed law requiring worldwide combined reporting, effective for 1993 and later years.¹³ In a worldwide combination, an FSC is included, and its dividends are eliminated as intercompany.

The Legislature also enacted law in 1993 whereby a multistate corporation could elect to determine its income from Idaho sources using a water's-edge basis¹⁴ (commonly referred to as a domestic combination). The option of filing a unitary combination on a water's-edge basis provides in part that, notwithstanding § 63-3027, a "qualified taxpayer" could elect to determine its income from Idaho sources using a water's-edge election, pursuant to chapter 30 of title 63 "as modified by" §§ 63-3027B through 63-3027E. Section 63-3027B(b)(3) provides as follows:

A "qualified taxpayer" is a corporation which files, with the state income tax return on which the water's-edge election is made, a consent to the reasonable production of documents

¹⁰ J. R. *Simplot Co., Inc. v. Idaho St. Tax Com'n.*, 120 Idaho 849, 820 P.2d 1206 (1991).

¹¹ J. R. *Simplot Co. v. Idaho St. Tax Com'n.*, 120 Idaho 849, 820 P.2d 1206 (1991).

¹² Idaho Code § 63-3022.

¹³ H. B. 404, 1993 Idaho Sess. Laws, ch. 284, p. 958.

¹⁴ H. B. 404, 1993 Idaho Sess. Laws, ch. 284, p. 958.

within the taxing jurisdiction. The consent shall remain in effect so long as the water's-edge election is in effect.

It is undisputed that the petitioner did not file a water's-edge election containing the consent; thus, the petitioner is not a "qualified taxpayer" and is not entitled to the water's-edge treatment. Since the petitioner did not file on a water's-edge basis, the "default" for multistate corporations for tax years 1993 and thereafter is worldwide combination; therefore, the amount of FSC income included in the worldwide combination is determined in accordance with Idaho Code Section 63-3027. For the years at issue, Idaho Code Section 63-3027, in pertinent part, reads as follows:

63-3027. Computing Idaho taxable income of multistate or unitary corporations. The Idaho taxable income of any multistate or unitary corporation transacting business both within and without this state shall be computed in accordance with the rules set forth in this section:

...

(t) For purposes of this section and sections 63-3027B through 63-3027E, Idaho Code, the income of two (2) or more corporations, wherever incorporated, the voting stock of which is more than fifty percent (50%) owned directly or indirectly by a common owner or owners, when necessary to accurately reflect income, shall be allocated or apportioned as if the group of corporations were a single corporation, in which event:

(1) The Idaho taxable income of any corporation subject to taxation in this state shall be determined by use of a combined report which includes the income, determined under subparagraph (2) of this subsection, of all corporations which are members of a unitary business, allocated and apportioned using apportionment factors for all corporations included in the combined report and methods set out in this section. The use of a combined report does not disregard the separate corporate identities of the members of the unitary group. Each corporation which is transacting business in this state is responsible for its apportioned share of the combined business income plus its nonbusiness income or loss allocated to Idaho, minus its net operating loss carryover or carryback.

(2) The income of a corporation to be included in a combined report shall be determined as follows:

(i) for a corporation incorporated in the United States or included in a consolidated federal corporation income tax return, the income to be included in the combined report shall be the taxable income for the

corporation after making appropriate adjustments under the provisions of section 63-3022, Idaho Code;

(ii) for a corporation incorporated outside the United States, but not included in subsection (t)(2)(i) of this section, the income to be included in the combined report shall be the net income before income taxes of such corporation stated on the profit and loss statements of such corporation which are included within the consolidated profit and loss statement prepared for the group of related corporations of which the corporation is a member, which statement is prepared for filing with the United States securities and exchange commission. If the group of related companies is not required to file such profit and loss statement with the United States securities and exchange commission, the profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used to obtain net income before income taxes. In the alternative, and subject to reasonable substantiation and consistent application by the group of related companies, adjustments may be made to the profit and loss statements of the corporation incorporated outside the United States, if necessary, to conform such statements to tax accounting standards as required by the Internal Revenue Code as if such corporation were incorporated in the United States and required to file a federal income tax return, subject to appropriate adjustments under the provisions of section 63-3022, Idaho Code; and

(iii) if the income computation for a group under paragraphs (i) and (ii) of this subsection results in a loss, such loss shall be taken into account in other years, subject to the provisions of subsections (c) and (d) of section 63-3022, Idaho Code.

...

Idaho Code Section 63-3027(t)(a)(ii) clearly mandates that for “a corporation incorporated outside the United States, . . . the income to be included in the combined report shall be the net income before income taxes of such corporation stated on the profit and loss statements. . . .” This treatment was followed by the auditor and is consistent with the law. Therefore, the Tax Commission sustains the Notice of Deficiency Determination on this issue.

WHEREFORE, the Notice of Deficiency Determination dated March 3, 2000, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER the petitioner to pay the following tax and interest (calculated through January 31, 2001):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
1994	\$146	\$69	\$215
1996	\$1,419	427	1,846
1997	\$2,656	567	3,223
1998	\$1,155	158	1,313
		TOTAL DUE	<u><u>\$6,597</u></u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner's rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2000.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE BY MAIL

I hereby certify that I have on this ____ day of _____, 2000 served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED] Receipt No. [Redacted]
[REDACTED]
[REDACTED][REDACTED]
