BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of [REDACTED] Petitioner.	))))))	DOCKET NO. 15696 DECISION

On May 4, 2001, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (the "taxpayer"), proposing a deficiency in income taxes and interest for tax years ending [Redacted]/96, [Redacted]/97, and [Redacted]/98 in the total amount of $36,321.

On July 5, 2001, a document, comprising a timely protest, petition for redetermination, and claim for refund, was filed by the taxpayer. An informal conference was requested by the taxpayer and held on October 18, 2001.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision MODIFYING the Notice of Deficiency Determination. The issues for decision are: (1) treatment in the sales factor of repurchase transactions; (2) treatment in the sales factor of gross proceeds of trading in securities; (3) treatment of a [Redacted] distribution from a [Redacted] and (4) deductibility of expenses paid by the taxpayer on behalf of its foreign subsidiaries when computing the foreign subsidiaries' income.

FACTS

The taxpayer's primary business is [Redacted]. The taxpayer files a worldwide combined return in Idaho.

Sales factor issues

The sales factors in the taxpayer's combined Idaho returns included certain gross receipts [Redacted] (collectively, the "securities trading business"), all of which actively trade financial instruments for their own account as a primary business activity. All the trading activities take place outside Idaho in the taxpayer's [Redacted] state and in [Redacted]. The securities trading business is highly leveraged but also employs over [Redacted] dollars of capital and [Redacted] people. The taxpayer takes pains to emphasize the active nature of the trading business and the distinction between it and its treasury function. The receipts in question do not arise from mere holding of passive investments. The following amounts of gross proceeds are disputed:

Table 1.

Transaction type	[Redacted]96	[Redacted]97	[Redacted]98
1. Sale	[Redacted]	[Redacted]	[Redacted]
2. Sale/buyback and buy/sellback	[Redacted]	[Redacted]	[Redacted]
3. Repo and reverse repo	[Redacted]	[Redacted]	[Redacted]
4. Total	[Redacted]	[Redacted]	[Redacted]

The sales in line (1) were reported in the sales factor. The repurchase transactions in lines (2) and (3) were not reported but are the subject of a refund claim. We now discuss the mechanics of the three types of claimed transactions in more detail.[1]

Sales

The taxpayer has an active business of trading in securities, including government and municipal bonds and corporate stocks of [Redacted] companies. If the security is a debt

[1] The taxpayer provided more extensive factual background on the gross receipts issues for its protest of the audit of the periods ending [Redacted]93, [Redacted]/94, and [Redacted]95 than it has provided for the audit that is the subject of this decision. This narrative draws in part on the earlier factual information, which does not appear to have changed.

instrument not traded on an exchange, then a custodial account at a bank is used to clear the trades. Transactions in exchange-traded securities are done through an outside broker.

The taxpayer was unable to provide holding periods for the sold assets. On the federal returns, the income was reported as “other income,” without reporting holding periods. At the informal conference, the representative stated that the average holding period was 14 days.

The taxpayer provided documentation for a sample set of transactions, which included the purchase of a [Redacted] [Redacted] bond and sale of an identical bond (that might or might not be the same bond that was purchased) four days later. The settlement period was seven days on each leg. While the sale was awaiting settlement, the taxpayer did a sell-buyback on the bond (see below for description of sell-buybacks), ultimately taking delivery of the same or an identical bond from the counterparty to the sell-buyback. The overall result to the taxpayer was net interest income of [Redacted] and a principal gain of [Redacted], for a total of [Redacted] on [Redacted] of claimed gross receipts between Oct. 21 and Nov. 1, [Redacted]. The profit was about .078% of the claimed gross receipts from the two “sales.” If the two “sales” are treated as sales, then this single bond (or pair of identical bonds) was responsible for generating approximately US[Redacted] in receipts.

Repos or sell/buybacks

A repurchase agreement or repo is essentially a borrowing transaction, typically involving a security issued by the U.S. government or a U.S. agency, with a domestic lender as counterparty. A sell/buyback (SBB) involves a [Redacted] foreign security and a foreign counterparty. The taxpayer provided a copy of the “master repurchase agreement” published by the Bond Market Association (used for domestic repos) and the “global master repurchase agreement” published by the International Securities Market Association in Zurich (used for

SBBs of foreign bonds).

The repo or SBB transaction is documented as a sale of the security by the taxpayer and a prearranged repurchase by the taxpayer at a higher price.[2] The uplift in price is negotiated based on the time value of money and is effectively interest income to the counterparty and interest expense to the taxpayer. The contracts provided by the taxpayer state the repurchase price in terms of the "price differential," which in turn is stated as the "pricing rate" times the number of days of the term of the loan, divided by 360 days (which is exactly the way in which commercial loan interest is computed).[3] Terms of repos can be overnight, term, or open. In the first leg of the transaction, the counterparty takes physical delivery of the security and gives the taxpayer cash.

The taxpayer may substitute other securities with the lender's consent, making a physical delivery of the new securities and physically taking the old securities back.[4] During the term of the agreement, the taxpayer is required to maintain a "margin." This means that the market value of securities collateralizing the loan must be a certain percentage of the loan amount. If there is a deficit in margin, then the borrower must give the lender additional securities or cash. If the margin exceeds the agreed percentage, then the lender must return the excess either in cash or collateral to the borrower on request.[5] Although the [Redacted] agreement is silent on this percentage, the facts recited in the *Loewenstein* court decision (discussed below) show that the

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[2] The taxpayer states in a letter dated March 28, 2002, that the taxpayer's repurchase price may occasionally be lower than the sale price, if the counterparty is unable to borrow the security to cover its short sale.

[3] Master Repurchase Agreement ¶ 2(k), (l) & (r)(Sept. 1996); Global Master Repurchase Agreement ¶ 2(dd), (ee) & (jj)(Nov. 1995).

[4] Master Repurchase Agreement ¶ 8 & 9 (Sept. 1996); Global Master Repurchase Agreement ¶ 8 (Nov. 1995).

[5] Master Repurchase Agreement ¶ 4 (Sept. 1996); Global Master Repurchase Agreement ¶ 4 (Nov. 1995).

margin percentage is greater than 100%; that is, the collateral always should exceed the amount of the loan.

During the pendency of the repo, the taxpayer also is entitled to receive "an amount equal to all Income paid or distributed on or in respect of the Securities that is not otherwise received by" the taxpayer, "to the full extent [the taxpayer] would be so entitled if the Securities had not been sold to Buyer."[6]

At the agreed time for the transaction to reverse, the counterparty returns the security, or an equivalent security, and the taxpayer repays a higher amount of cash than the taxpayer initially received.

The [Redacted] U.S. agreement states:

> Although the parties intend that all Transactions hereunder be sales and purchases and not loans, in the event any such Transactions are deemed to be loans, Seller shall be deemed to have pledged to Buyer as security for the performance by Seller of its obligations under each such Transaction, and shall be deemed to have granted to Buyer a security interest in, all of the Purchased Securities with respect to all Transactions hereunder and all Income thereon and other proceeds thereof.[7]

The [Redacted] U.S. agreement provides that if the Buyer is in default, then

> upon tender by the nondefaulting party of payment of the aggregate Repurchase Prices for all such transactions, all right, title and interest in and entitlement to all Purchased Securities subject to such Transactions shall be deemed transferred to the nondefaulting party, and the defaulting party shall deliver all such Purchased Securities to the nondefaulting party.[8]

Along with the documentation of the [Redacted] bond trade described above, the taxpayer provided the journal entries used to record it. When an SBB is agreed, the taxpayer on the date

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[6] Master Repurchase Agreement ¶ 5 (Sept. 1996); to similar effect, see Global Master Repurchase Agreement ¶ 4 (Nov. 1995).

[7] Master Repurchase Agreement ¶ 6 (Sept. 1996).

[8] Master Repurchase Agreement ¶ 10(c) (Sept. 1996); Global Master Repurchase Agreement ¶ 10(e) does not require delivery of the securities but requires a cash payment (Nov. 1995).

of the sale records both the sale and the repurchase, using balance sheet entries only. The interest expense on the SBB and the discount interest on the security are netted and recorded each day to

"trading gain/loss." When the sale and buy legs are settled, again only balance sheet entries are used. The taxpayer reclassifies trading gain/loss on repo-type transactions to interest income/expense for federal tax purposes.

The taxpayer uses repos and SBBs to

[Redacted]

The taxpayer states that repos and SBBs differ in their treatment of income earned from the issuer of the collateral security. In a repo, during the term of the agreement, the taxpayer retains the right to receive the income on the security. But in an SBB, the taxpayer states that the lender receives the income, but interest payable by the taxpayer is reduced to that extent. This last distinction is not borne out by the two form contracts the taxpayer provided; these both state that the seller/borrower has the right to the income on the security during the pendency of both a repo and an SBB.

Buy/sellbacks or reverse repos

A BSB or reverse repo is the same as an SBB or repo, except that the taxpayer is in effect a lender rather than a borrower. A BSB usually involves a foreign security and foreign counterparty, while a reverse repo involves a U.S. security and a domestic counterparty.

Comparison of receipts to profits

The following table shows the taxpayer's claimed apportionment factors:

Table 2.

	[Redacted]96	[Redacted]97	[Redacted]98
Property factor	[Redacted]	[Redacted]	[Redacted]
Payroll factor	[Redacted]	[Redacted]	[Redacted]
Sales factor per audit	[Redacted]	[Redacted]	[Redacted]
Sales factor per taxpayer	[Redacted]	[Redacted]	[Redacted]
Average factor per audit	[Redacted]	[Redacted]	[Redacted]
Average factor per taxpayer	[Redacted]	[Redacted]	[Redacted]
Taxpayer factor ÷ audited factor	87%	86%	83%

The taxpayer's representative argues that the sales factor should be close to the property and payroll factors to avoid distortion.

It is undisputed that the profits and losses on the disputed transactions are business income. The taxpayer was unable to provide the actual taxable income by type of claimed transaction by year, but stated that "the [securities trading transactions] resulted in low margin transactions. This is what one would expect from trades in commodities where the holding period is relatively short."

Receipts and profits are summarized in the following table:

Table 3.

	[Redacted]93	[Redacted]94	[Redacted]95
1. Audited gross receipts (no disputed sales included)	[Redacted]	[Redacted]	[Redacted]
2. Claimed additional receipts (=Table 1, line 4)	[Redacted]	[Redacted]	[Redacted]
3. Total receipts per taxpayer (= line 1 + line 2)	[Redacted]	[Redacted]	[Redacted]

	[Redacted]93	[Redacted]94	[Redacted]95
4. Claimed receipts as % of total receipts (= line 2 ÷ line 3)	63.89%	79.29%	71.90%
5. Apportionable income per audit	[Redacted]	[Redacted]	[Redacted]
6. Net income from claimed transactions	Unknown	Unknown	Unknown
7. Claimed transactions as % of apportionable income (= line 6 ÷ line 5)	Unknown	Unknown	Unknown

If only the "sale" receipts are considered, and the repo-type transactions are ignored, then the comparison is as follows:

Table 4.

	[Redacted]93	[Redacted]94	[Redacted]95
1. Audited gross receipts (no disputed sales included)	[Redacted]	[Redacted]	[Redacted]
2. Claimed additional receipts (=Table 1, line 1)	[Redacted]	[Redacted]	[Redacted]
3. Total receipts per taxpayer (= line 1 + line 2)	[Redacted]	[Redacted]	[Redacted]
4. Claimed receipts as % of total receipts (= line 2 ÷ line 3)	47.58%	57.77%	44.29%
5. Apportionable income per audit	[Redacted]	[Redacted]	[Redacted]
6. Net income from claimed transactions	Unknown	Unknown	Unknown
7. Claimed transactions as % of apportionable income (= line 6 ÷ line 5)	Unknown	Unknown	Unknown

[REDACTED] issue

A member of the taxpayer's unitary group, before the member was acquired by the taxpayer, formed a subsidiary in [Redacted], and that subsidiary elected to be treated as a [REDACTED] for tax years ending [Redacted]81 through [Redacted]84. The taxpayer did not include the [REDACTED] in an Idaho combined return for those years. The [REDACTED] was liquidated into the member in [Redacted]. On audit, the Internal Revenue Service (IRS) determined that the [REDACTED] did not meet the qualifications for [REDACTED] treatment in the 1981-1984 period. The [REDACTED] therefore did not qualify for [Redacted] under the Internal Revenue Code.

The taxpayer and the IRS agreed that the [REDACTED] would make a [Redacted] of [Redacted] income to its parent in the tax year ending [Redacted]97, and the distribution was made accordingly. The distribution was included in the taxpayer's consolidated federal taxable income for the [Redacted]97 year. The taxpayer now claims that the [Redacted] income would have been subject to Idaho income tax in the 1981-1984 period, so the [Redacted] distribution should not be included in apportionable income in 1997.

Expenses of foreign subsidiaries

In the first two years of the audit period, the taxpayer paid certain expenses, described as "salary pension payments," on behalf of its foreign subsidiaries; in the third year, this payment appears as a negative amount. The taxpayer did not deduct these expenses in its consolidated federal return, but deducted them in its Idaho worldwide combined return.

LAW AND ANALYSIS

SBBs, repos, BSBs and reverse repos are secured loans and not sales

A transaction structured as an SBB or repo is in substance a secured loan, in which the initial "sale" leg is simply the obtaining of loan proceeds by the borrower. The same is true in the case of BSBs and reverse repos, where the first "purchase" leg is the funding of the loan by the lender. Neither the first leg of an SBB/repo or the second leg of a BSB/reverse repo should be treated as "sales" for purposes of the sales factor. This conclusion finds support in two legal doctrines.

Lender's interest income is not
U.S. interest subject to exemption from tax

Under federal law, a state may not impose income tax on interest on federal obligations.[9] The U.S. Supreme Court has upheld a state's taxation of a lender's interest income earned on repos secured by Treasury securities. *Nebraska Dep't of Rev. v. Loewenstein,* 513 U.S. 123 (1994).

Justice Thomas' opinion for the Court focused on a number of factors. First, the interest rate on the loan bears no relation to either the coupon interest rate, or the discount interest, on the government securities that serve as collateral. If the borrower defaults, the lender may liquidate the collateral, but must pay the borrower any proceeds in excess of the loan plus expenses, and may recover any shortfall from the borrower; in other words, the borrower still bears the risk of market fluctuation in the value of the collateral. The borrower must maintain "margin," or collateral whose market value exceeds the amount of the loan by 2%, and the lender must return collateral in excess of the 102% level. And finally, the borrower has the right to substitute Treasury securities of equal value. It does not matter that the lender takes "delivery" of the collateral at the beginning of the loan, since such "delivery" under commercial law perfects the lender's security interest in the collateral. "[I]n economic reality, the [buyers/lenders] receive interest on cash they have lent to the Seller-Borrower."[10]

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[9] 31 U.S.C. § 3124(a).

[10] 513 U.S. at 134.

The Supreme Court also held that the parties' characterization of the repo agreement as a "sale" was not controlling. Even if the lender/buyer owns the collateral during the term of the repo, the lender/buyer does not earn U.S. interest within the meaning of § 3124. The Court expressed no opinion on the characterization of repos under any other law, such as bankruptcy or securities law.

The Supreme Court's opinion on its face is limited to the precise issue of whether the lender's interest income is exempt as U.S. interest. But the Tax Commission agrees that repo transactions are secured loans "in economic reality." Receipt by a borrower of loan proceeds, and receipt by a lender of loan repayment, are not sales. The legal enforceability of the legs of the transaction according to its terms, and coverage of the transaction according to its terms under statutes such as the securities laws, do not alter the economic substance.

Step transaction doctrine

Idaho income tax law expressly incorporates federal interpretations of income and deductions, so that taxable income is the same for Idaho and federal purposes. Idaho Code § 63-3002. Although federal law has no counterpart to the Idaho concepts of apportionment and the sales factor, the federal concept of "step transactions" also applies to apportionment factors, because the factors need to match the income. In particular, the sales factor needs to match gross income, both as to nature and timing.

The step transaction doctrine requires that tax consequences be determined by the end result of a series of prearranged steps rather than viewing earlier steps in isolation. The doctrine is amply explained, with authorities, at MERTENS, LAW OF FEDERAL INCOME TAXATION § 43.253 *et seq.* Here, in a repo, the "sale" occurs with a prearranged repurchase already agreed to. The step transaction doctrine applies the tax law to both steps as a whole, rather than looking separately at the sale and the repurchase. The purported sales are not "sales" for tax purposes because they are canceled out by prearranged repurchases that form part of a unitary (so to speak) series of transactions. In a reverse repo, they are preceded by purchases that are similarly unitary.

Conclusion on repo-type transactions

Accordingly, the Tax Commission holds that the principal portions of the repo-type transactions are not "sales" within the meaning of Idaho Code § 63-3027. The profits realized on them in the form of interest income are "sales." The claim for refund is denied as to the repo-type transactions, and the audit treatment is sustained. We turn now to the straight sales of securities that are not accompanied by offsetting purchases.

The "sale" receipts are not "sales"
within the meaning of the sales factor
to the extent the instruments are held to maturity
or called or redeemed by the issuer
and the proceeds are returns of capital

It is undetermined whether any of the taxpayer's claimed receipts from sales of securities, unaccompanied by prearranged, offsetting purchases, were actually from the issuer(s) of the respective securities as a result of maturity, calling, or redemption of the securities. To the extent this is the case and to the extent of the taxpayer's return of capital, the Tax Commission's position is that such receipts are not "sales" within the meaning of the sales factor. Instead, they are repayments of loans to the taxpayer, with the taxpayer acting as a creditor. Only the interest element of such receipts would be "sales."

It is not necessary at this time to establish the exact amount of such receipts, because the Tax Commission reaches the same result on a broader ground as to these receipts and others, as discussed next.

Inclusion of the return of capital portion of the "sale" receipts distorts the apportionment formula

Standard apportionment formula

The division of corporate income among the states is inherently imprecise and often vexing. The states are free to divide income among themselves so long as they do not violate the Due Process and Commerce Clauses of the federal Constitution, as interpreted by the United States Supreme Court. That Court has stated: "Allocating income among various taxing jurisdictions bears some resemblance ... to slicing a shadow."[11] The process is imperfect and relies on assumptions and approximations.

In 1965, Idaho adopted, with slight modification, the Uniform Division of Income for Tax Purposes Act (UDITPA). Idaho Code § 63-3027. UDITPA sets forth rules for determining the portion of a corporation's total income from a multistate/multinational business which is attributable to Idaho, and therefore, subject to Idaho's income tax. UDITPA divides a corporation's income into two classes: business income and nonbusiness income. Business income is apportioned by a three-factor formula, Idaho Code § 63-3027(i), while nonbusiness income is allocated to a specific jurisdiction, Idaho Code § 63-3027(d)-(h). The three-factor formula uses property, payroll, and sales as indicators of the relative activity of the taxpayer in the respective states. Idaho Code § 63-3027(s) permits deviations from the three-factor formula in certain cases.

Idaho Code § 63-3027 provides in pertinent part as follows (emphasis added):

> 63-3027. COMPUTING TAXABLE INCOME OF CORPORATIONS. The Idaho taxable income of any corporation with a business situs in this state shall be computed and taxed in accordance with the rules set forth in this section:

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[11]Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 192 (1983).

> (a) As used in this section, unless the context otherwise requires:
>
> . . .
>
> > (5) *"Sales" means all gross receipts* of the taxpayer not allocated under subsections (d) through (h) of this section.
>
> . . .
>
> (o) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.
>
> . . .

As shorthand, the foregoing definition of the sales factor is referred to herein as "standard UDITPA."

The taxpayer is a dealer in securities. Securities are not tangible property. The taxpayer's securities trading occurs outside Idaho, so that the claimed receipts would inflate the sales denominator without any corresponding Idaho portion in the numerator. This is because § 63-3027(r)(2) generally assigns sales other than sales of tangible property to the state where the income-producing activity is performed, which would be outside Idaho on these facts.

Equitable apportionment in general

Idaho Code § 63-3027 provides in pertinent part (emphasis added):

> (s) If the allocation and apportionment provisions of this section *do not fairly represent the extent of the taxpayer's business activity in this state,* the taxpayer may petition for or *the state tax commission may require*, in respect to all or any part of the taxpayer's business activity*, if reasonable*:
>
> > (1) Separate accounting, provided that only that portion of general expenses clearly identifiable with Idaho business operations shall be allowed as a deduction;
> >
> > (2) The exclusion of any one (1) or more of the factors;
> >
> > (3) The inclusion of one (1) or more additional factors which will fairly represent the taxpayer's business activity in this state; or

> (4) *The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.*

The Idaho language is substantially identical to § 18 of the original UDITPA. (State tax practitioners commonly refer to state statutes patterned on that section as "section 18" provisions.) The above statute is referred to as the "alternative" apportionment provisions, as distinguished from standard UDITPA.

Standard UDITPA is presumed to be applicable to apportion business income. If either party wishes to vary from the standard formula, that party must establish that (1) standard UDITPA does not fairly represent the extent of the taxpayer's business activity in this state; and (2) the party's proposed formula is reasonable. Assessing the fairness of representation requires one to compare the result under standard UDITPA with an ideal standard of "fair representation."

Judicial authority in Idaho on this point is limited to one case, in which a railroad company taxpayer included both its freight revenues and proceeds of sales of its accounts receivable in the sales factor, with the receivables proceeds, conceded by the State to be "sales," appearing only in the denominator. In a terse opinion, the Idaho Supreme Court held that this practice amounted to double counting of the same income and hence distorted the apportionment formula. *Union Pacific Corp. v. Idaho State Tax Comm.*, 136 Idaho 34, 28 P.3d 375 (2001).

Union Pacific may govern the repo-type transactions, to the extent the same or a substantially identical security is sold twice. But the facts of *Union Pacific* are not close enough to the other disputed sales here to determine the outcome as to those sales. We turn to U.S. Supreme Court cases and other authorities for further guidance.

U.S. Supreme Court case law on apportionment

The cases of the United States Supreme Court under the Commerce and Due Process Clauses of the federal Constitution give some guidance on the permissible constitutional limits of fair apportionment within which states may design apportionment formulas and so shed light on fair apportionment.

The leading case is *Hans Rees' Sons, Inc. v. North Carolina*.[12] Hans Rees bought leather, manufactured it in North Carolina, stored a large amount of products in New York, and, through a sales office in New York, sold the products all over the United States and in foreign countries. North Carolina employed an apportionment formula with a single factor—the ratio of North Carolina property to total property. Since Hans Rees' factory was in North Carolina, the North Carolina statute attributed over 80% of Hans Rees' income to North Carolina. Hans Rees used its internal records to assign only between 17% and 21.7% of its total profits to North Carolina. The detailed computations are not published in either the state or United States Supreme Court opinions; but Hans Rees appears to have used "separate accounting"—determining profit by constructing hypothetical arm's length sales of raw materials, work in process, and finished goods at various stages of the business. The North Carolina Supreme Court refused to accept this approach, reasoning that:

> [T]he petitioner undertakes to split into independent sources income which . . . was created and produced by a single business enterprise. . . . The petitioner was conducting a unitary business . . . and . . . it is not permissible to lop off certain elements of the business constituting a single unit, in order to place the income beyond the taxing jurisdiction of the state.[13]

[12]283 U.S. 123 (1931).

[13]Maxwell v. Hans Rees' Sons, Inc., 153 S.E. 850, 854-855 (N.C. 1930).

Surprisingly, in light of its previous[14] and subsequent[15] endorsement of the unitary business principle and dim view of separate accounting, the United States Supreme Court reversed, saying in part:

> For the present purpose, in determining the validity of the statutory method as applied to the appellant, it is not necessary to review the evidence in detail, or to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina. It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method ... operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. . . .[16]

The Court alluded critically to North Carolina's apportionment of "the entire net income"[17] of Hans Rees to North Carolina. The Court evidently felt that, based on sales, some portion of the income ought in fairness to be apportioned outside North Carolina.

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[14]*E.g.*, Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

[15]*E.g.*, Butler Bros. v. McColgan, 315 U.S. 501 (1942).

[16]283 U.S. at 135.

[17]283 U.S. at 133.

Hans Rees was followed by *Moorman Mfg. Co. v. Bair*,[18] where in a converse factual situation (factory in Illinois which uses three-factor formula, 20% of sales in Iowa which uses single-factor ratio of Iowa sales to total sales), the Court refused to invalidate the tax. The Court found that Moorman had "failed to establish a basis for comparison of its actual income in Iowa with the income apportioned to Iowa under the single-factor formula" and therefore could not prove that the Iowa formula was unconstitutional.[19] The reference to "actual income in Iowa" is obscure, implying that there is some fixed number that is the "actual income."[20]

In *Container Corp. of America v. Franchise Tax Bd.*,[21] the Court stated that an apportionment formula must be both internally and externally consistent. Internal consistency requires that the formula "must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." External consistency requires that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated."[22] The Court went on to state:

> The Constitution does not "invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing state . . . ." . . . Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted in that State,' or has 'led to a grossly distorted result.'"[23]

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[18]437 U.S. 267 (1978).

[19]437 U.S. at 275 n. 9.

[20]The Court later dismissed this reference to "actual income" as dicta. Exxon Corp. v. Wisconsin Dep't of Rev., 447 U.S. 207, 223 (1980).

[21]463 U.S. 159 (1983).

[22]463 U.S. at 169.

[23]463 U.S. at 169-70 (citations omitted; emphasis original).

Container was a modern multinational corporation. It challenged California's practice of worldwide combined reporting, including application of the standard UDITPA formula to multinational operations. Container also alleged that the standard UDITPA formula distorted income because property, payroll, and sales in foreign countries were more profitable than those factors in California.

The Court replied:

> The problem with this argument is obvious: the profit figures relied on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place. Indeed, we considered and rejected a very similar argument in *Mobil*, pointing out that whenever a unitary business exists, "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. . . ."[24]

Describing *Hans Rees*, the Court said:

> Some methods of formula apportionment are particularly problematic because they focus on only a small part of the spectrum of activities by which value is generated. Although we have generally upheld the use of such formulas, see, *e.g., Moorman . . .; Underwood Typewriter* . . ., we have on occasion found the *distortive effect of focusing on only one factor* so outrageous in a particular case as to require reversal. In *Hans Rees' Sons, Inc.* . . ., for example, [the single factor property formula] resulted in an attribution to North Carolina of between 66% and 85% . . ., while a separate accounting analysis purposely skewed to resolve all doubts in favor of the State resulted in an attribution of no more than 21.7%.[25]

The Court concluded:

> Of course, even the three-factor formula is necessarily imperfect. But we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged . . . by appellant. . . .

[24]463 U.S. at 181.

[25]463 U.S. at 182-183 (citations truncated; emphasis added).

> [T]he percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business.[26]

The Court therefore sustained both worldwide combined reporting and the standard UDITPA formula.

The quoted passages in *Container* present *Hans Rees* as a case of an inappropriate single-factor apportionment formula. The defect of the North Carolina formula was its failure to reflect a reasonable sense of how income is generated. The Court in *Hans Rees* grudgingly allowed a separate accounting analysis to support its visceral conviction that North Carolina's single-factor formula was unreasonable. On the other hand, Container's attempt to impeach California's three-factor formula was denied because payroll, property, and sales are more rational in combination than any one of them alone. The complexity of Container's multistate and multinational business—compared to the relative simplicity of a Hans Rees or a Moorman—may have also contributed to the Court's refusal to reenter the separate accounting arena.

Unfortunately, subsequent interpreters of *Hans Rees* and *Container* have seized on the 250% reference in the above quoted passage from *Container*. For example, in *Merrill Lynch*[27] discussed in detail below, the California State Board of Equalization said that it is not sufficient for the Franchise Tax Board to come up with its own opinion of a better apportionment formula under UDITPA § 18, at least so long as the difference between the parties was only 170% as opposed to 250+%.

The Tax Commission is skeptical of the usefulness of the 250% benchmark. It is not clear

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[26] 463 U.S. at 183-184 (footnote and citations omitted).

[27] Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc., 89-SBE-017, Cal. CCH ¶ 401-740, 1989 WL 95886 at *5 (Cal. St. Bd. Eq., 1989).

whence the United States Supreme Court in *Container* derived the 250% figure, since the narrowest difference between the parties in *Hans Rees* was 300% (66% versus 21.7%), and the widest difference was 500% (85% versus 17%). And more fundamentally, the distortion in *Hans Rees* was measured from a benchmark of separate accounting, which is disfavored in apportionment analysis as evidenced by *Container* itself. A reflexive comparison of the parties' numbers against a 250% bright line misapplies the cases. Instead, the inquiry must focus on the nature of the business being taxed and how its income is generated.

Burden of proof

Idaho Code § 63-3027(s) provides that the taxpayer may petition for, and the Commission may require, alternative apportionment. If the taxpayer petitions, it bears the burden of proving unfair representation by the standard UDITPA formula.[28] Courts in other states have imposed upon the taxing agency the burden of proof when it invokes alternative apportionment.[29] Although only the sales factor is analyzed below, it is only the ultimate apportionment result using all three factors in combination that must pass the test of fair representation and reasonableness. The Tax Commission agrees with the statement of the California State Board of Equalization in *Merrill Lynch* that:

> Distortion in one factor . . . does not necessarily result in unfair reflection of the business activity in the state; the other two factors may well mitigate the distortive effect of the third, so that, ultimately, the taxpayer's business activity in the state is fairly represented through the combination of the three factors in the apportionment formula. However, it is also possible that one factor may be so distortive that the other two do not mitigate its effect on the formula as a whole. Therefore, whether distortion must be shown in all or just one of the factors will depend upon the ultimate distortive effect that

[28]Burlington Northern, Inc. v. Idaho State Tax Comm'n, 126 Idaho 645 (1995).

[29]*E.g.,* Donald M. Drake Co. v. Dep't of Rev., 263 Or. 26, 500 P.2d 1041 (1972).

occurs when all three factors are considered in combination.[30]

Tax Commission decisions on
intangibles sales in sales denominator

The treatment in the sales factor denominator of various types of transactions in intangibles has been a persistent source of controversy in Idaho and other states in recent years.

The Tax Commission has issued four decisions denying similar or analogous claims. In Docket No. 11220 (1997), a large bank had a division that carried on an active trade or business of trading in bonds, selling them to its customers. Applying a distortion analysis similar to that herein, the Tax Commission held that the bond trading business should be separately apportioned despite its unity with the rest of the bank.

In Docket No. 12155 (1998), a manufacturing company invested working capital in short-term time deposits with an average maturity of 2.7 days and an average size of $10.2 million, generating 446 maturities in a typical year, for gross receipts of $4.5 billion. It also invested lesser sums in other interest bearing investments, all held to maturity, for total receipts of $5.3 billion (including the $4.5 billion just mentioned). Net profit on this activity was $2.4 million in the year analyzed. In contrast, annual Idaho sales were in the $9-$12 million range, and sales of merchandise were about $3 billion per year. The Tax Commission held that the intangible receipts,

[30]Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc., 89-SBE-017, Cal. CCH ¶ 401-740, 1989 WL 95886 at *3 (Cal. St. Bd. Eq., 1989).

to the extent they represented returns of capital, were not "sales" and so did not belong in the sales factor.[31]

In Docket No. 12131 (1998), a manufacturing company bought and sold "auction preferred stock" (APS) and municipal securities, comprising about 27% to 38% of total receipts. The APS in substance was found to be a sophisticated debt instrument that generated deductible dividends for income tax purposes. Among its transactions in municipal securities, the company repeatedly bought $5 million to $10 million of certain municipal bonds and resold them the following day, generating receipts of $170 million from those particular securities in a single month. The Tax Commission held that the APS and municipal securities were in substance loans to the issuers, with the claimed receipts being repayments of such loans with interest. Hence the returns of capital did not belong in the sales factor.

In Docket No. 12715 (1999), the Tax Commission allowed the return of capital element of the gross proceeds of securities sales in the denominator of the sales factor where the securities in question had been held for a length of time and the taxpayer was therefore exposed to significant market risk. But the Tax Commission disallowed the return of capital element on other sales as distortive, similarly to the decision herein.

C*ase law in other states on securities sales*

Turning to other states, the most thoroughly analytical opinions are from California. California's sales factor law is derived from UDITPA and has the same wording as Idaho's. The California State Board of Equalization (SBE) reached opposite results in two cases on the issue of whether and how gross receipts from securities sales should be included in the sales factor.

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[31]*See also* Sherwin-Williams Co. v. Dep't of St. Rev., 673 N.E.2d 849 (Ind. Tax Ct. 1996); The Sherwin-Williams Co. v. Johnson, 989 S.W.2d 710 (Tenn. App. 1998), *appeal denied,* (Tenn. 1999); *but see* The Sherwin-Williams Co. v. Dep't of Rev., 996 P.2d 500 (Or. 2000); AT&T v. Dep't of Rev., 2000 WL 1279835 (Or. Tax Ct. 2000)..

Pacific Telephone was decided in 1978.[32] Pacific Telephone & Telegraph was a subsidiary of American Telephone & Telegraph Co. (AT&T) and was one of the regional Bell operating companies (RBOCs). Pacific filed a combined report in California that included the income and factors of the entire nationwide Bell System. The issue was whether the sales factor should include gross receipts from the sale and redemption of interest-bearing and discount securities.

The Bell companies, including Pacific, took working capital funds not currently needed in the business and invested them in short-term securities. AT&T's System-wide working capital pool exceeded $1 billion during the years in question. It was managed by AT&T's treasury staff in New York and was made available to the RBOCs on a daily basis as needed for their businesses. The pool consisted of T-bills, other governmental securities, bank CDs, and commercial paper. Most of the investments were held to maturity, but others were sold to meet cash needs. Pacific had its own, smaller pool, managed in San Francisco.

System-wide gross receipts from such sales were on the order of $8 billion per year, or 36% of total receipts. On the other hand, the net income (interest, gains, and losses) from the investment activities in the System was about $54 million per year, which was less than 2% of the combined apportionable income of the System. Pacific included in the California numerator only those receipts from its own pool, and none from the much larger AT&T pool, based on the respective management locations of the two pools (San Francisco versus New York). The net effect of Pacific's filing position was to assign about 11% of the System's apportionable income to New York. Pacific argued that the capital pool was extremely important to the unitary business and should be reflected in the factors.

The Franchise Tax Board (FTB) allowed the interest and net gains and losses in the factor,

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[32] Appeals of Pacific Tel. & Tel. Co., 1978 WL 3941 (Cal. St. Bd. Eq. 1978).

but disallowed the portion of sales receipts that was a return of capital. The FTB's disallowance was based on California's version of UDITPA § 18, which permits deviation from the standard formula if the formula "do[es] not fairly represent the extent of the taxpayer's business activity in the state." The FTB argued that it would be unreasonable to allow the activity of a few employees in New York, engaged in an incidental aspect of the unitary telecommunications business, producing only minor amounts of net income, to assign 11% of the Bell System's income to New York. The SBE agreed with the FTB.

UDITPA, as in effect in California for the years in issue, defined "sales" for factor purposes as "all gross receipts of the taxpayer" other than nonbusiness items; the SBE conceded that the investment receipts on their face qualified as such.[33] The SBE assigned the burden of proof of distortion to the party seeking to deviate from standard UDITPA—here, the FTB. The SBE stated that the purpose of the sales factor is to reflect the markets for the taxpayer's goods and services, which are not reflected by the property and payroll factors. The opinion continued:

> [T]he inclusion of this enormous volume of investment receipts substantially overloads the sales factor in favor of New York, and thereby inadequately reflects the contributions made by all the other states, including California, which supply the markets for the communications services provided by Pacific and its affiliates. Moreover, we are unable to accept, even for a moment, the notion that more than 11 percent of The Bell System's entire unitary business activities should be attributed to any single state solely because it is a center of working capital investment activities that are clearly only an incidental part of one of America's largest, and most widespread, businesses.

The SBE therefore concluded that the three-factor formula did not fairly represent the extent of Pacific's activity in California.

[33] Depending on the facts of particular types of transactions, the Idaho State Tax Commission might not make such a broad concession on the *Pacific* facts today.

The SBE then turned to whether the FTB's use of net receipts was reasonable. The SBE acknowledged that the working capital was essential to Pacific's business and therefore ought to be represented somehow in the factors; but its importance to Pacific was the same as "to any other business." The SBE concluded:

> We have serious doubts, however, whether the turnover of assets in those pools has any value to the unitary business beyond the income that it generates directly. In any event . . ., the contribution made by the pools is reflected in the payroll factor, which includes the payroll attributable to the employees who manage the pools, and in the sales factor, which [the FTB] has conceded should include the income element of the investment receipts. Whether this constitutes adequate or "reasonable" reflection of the working capital pools is, of course, the sort of subjective question which rarely lends itself to an indisputable conclusion. Under the facts of this case, however, we are not persuaded that reasonableness necessarily requires that the capital element of the investment receipts be included in the sales factor.

Thus, the SBE generally affirmed the FTB's denial of Pacific's refund claim.[34]

The taxpayer's claim finds support in the California State Board of Equalization's 1989 decision in *Merrill Lynch.*[35] Merrill Lynch trades securities in two capacities. First, it acts as a broker for its customers, using their money and charging them a commission for each trade; most of Merrill's California sales activity consisted of these brokerage sales. Second, it deals in securities for its own account as a principal or underwriter, using its own funds and making a profit or loss; these principal trading activities are mostly conducted in New York, presumably in anonymous

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[34]*See also* American Tel. & Tel. Co. v. State Tax Appeal Bd., 787 P.2d 754 (Mont. 1990); American Tel. & Tel. Co. v. Director, Div. of Tax'n, 476 A.2d 800, 802 (N.J. Super. 1984), *cert. den*., 483 A.2d 157 (N.J. 1984)(sales factor construed to exclude return of capital from securities turnover because "to do otherwise produces an absurd interpretation" of the sales factor. "The bulk of funds flowing back to AT&T from investment paper was simply its own money."); *cf.* Westinghouse Elec. Corp. v. Porterfield, 261 N.E.2d 272 (Oh. 1970)(statute unlike UDITPA; distortion theory employed); *contra,* Illinois Tool Works, Inc. v. Lindley, 436 N.E.2d 220 (Oh. 1982)(statute unlike UDITPA).

[35]Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc., 89-SBE-017, Cal. CCH ¶ 401-740, 1989 WL 95886 (Cal. St. Bd. Eq., 1989).

trades on exchanges.

Merrill reported the commissions from its California customers in its California sales numerator. Merrill also reported the gross receipts from its principal sales (including the return of capital portion) in its California sales denominator. The FTB reduced the denominator to reflect only the gross profits of the principal sales; that is, it deleted the return of capital portion, as done in *Pacific Telephone*.

The SBE held this time for Merrill. Here, the principal transactions were found to be "not . . . an incidental part . . . but . . . a fundamental segment of the financial services provided by" Merrill.[36] The SBE then stated that "[m]ore importantly, however, the FTB has made no showing of distortion such as was made in *Pacific Telephone*." The SBE did not accept the FTB's showing of gross distortion based on the size of the disparity between the sales factor computed using gross receipts versus using gross profits. The gross profit-based sales factor resulted in a three-factor result that was only 1.7 times the result using the gross receipts-based sales factor. This difference was

> much too slight to be justification for the application of [UDITPA § 18]. . . . These figures are, as the Supreme Court said of the difference in *Container Corp*. . . . "a far cry from the more than 250 percent difference which led us to strike down the state tax in *Hans Rees' Sons*, *Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business." . . . Even if . . . the FTB's method was more precise, that would not justify deviation from the standard method, as long as the standard method fairly reflects [Merrill's] business activity. [Citations omitted] We believe that a rough approximation of income attributable to this state would, in most cases, and certainly in this one, constitute a fair reflection of the taxpayer's business activity in the state.[37]

[36] 1989 WL 95886 at *4.

[37] 1989 WL 95886 at *5.

Thus, the SBE held that Merrill could include in the sales factor denominator its entire gross receipts from principal trading.[38]

Comparison of the two SBE decisions reveals the following differences. *Merrill*, unlike *Pacific*, did not compare the taxable income generated by the principal trading with Merrill's total apportionable income. It is likely that the principal trading generated a much larger portion of Merrill's apportionable income than the treasury function did of Pacific's. And *Pacific* did not compare the average of the three factors under the gross receipts and gross profits methods; it merely stated that Pacific's method would assign an 11% factor to New York.

Tax Commission's interpretation of distortion

The lesson the Tax Commission draws from *Pacific* and *Merrill* is that one must compute the percentage of apportionable income generated by the investment activity and compare it with the percentage of combined gross receipts from that activity. Here, referring to Table 4 above, the taxpayer's securities trading generated an undetermined but admittedly modest percentage of apportionable income. But the return of capital element of the "sale" receipts was between 44% and 58% of combined gross receipts with that return of capital element included. So far as the Tax Commission has been able to determine, given the scanty information provided by the taxpayer, the securities trading business has a low profit margin, probably much lower than that of the rest of the taxpayer's group. Based on this showing, the Tax Commission finds that inclusion of the return of capital from securities sales in the combined sales factor results, along with the other factors, in an apportionment that does not fairly represent how the taxpayer earns its income.[39]

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[38]*Cf.* Western Elec. Co. v. Norberg, AA No. 81-391 (Dist. Ct., R.I., 1983), CCH R.I. ¶ 200-145, *cert. den.*, 461 A.2d 679 (R.I. 1983)(after this decision, Rhode Island amended its law so that only the net income from the sale of securities or other financial obligations is included in the sales factor); U.S. Steel Corp. v. Wisconsin Dep't of Rev., CCH Wis. ¶ 202-564, 1985 WL 19912 (Wis. Tax App. Comm'n, 1985)(after this decision, Wisconsin also amended its law).

[39]Distortion is also an alternative ground for excluding the repo-type transactions from the sales factor, in the event

The taxpayer argues that the sales factor should be close to the property and payroll factors in order to avoid distortion. The Tax Commission is aware of no authority for this proposition. If the property and payroll factors were supposed to be close to the sales factor, then there would be no need for a three-factor formula in the statute.

Remedy for distortion

Having found unfair representation, the next question is how to modify the factor to make it fair. The auditors here excluded all securities sales from the sales factor. The fact pattern has parallels to *Pacific Telephone*. But unlike the treasury operations in *Pacific*, which are basically "staff" adjuncts to the "core" operating business, the trading here is a separable, active business carried on by the taxpayer.

The Tax Commission here rejects separate apportionment of the securities trading business, such as was employed in Docket No. 11220 (1997), as a solution to the distortion. The taxpayer's trading business is quite complex, [Redacted], making separate accounting for expenses, property and payroll even less reliable than it was on the facts in Docket No. 11220. Separate apportionment, while not without theoretical merits, is out of step with the mainstream of current thinking. Since the issuance of Docket No. 11220, the Tax Commission is unaware of any administrative or judicial decision adopting separate apportionment as a remedy for factor distortion.

Instead, the Tax Commission here holds that the return of capital portion of the taxpayer's sales proceeds is to be excluded from the sales factor. The profit portion (interest, dividends, and gains) is allowed. In the absence of accurate figures despite a request for them, the Tax Commission employs 5% of gross proceeds as the best estimate of the profit portion, and this amount is added to

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the sales legs of repo-type transactions are held to be "sales" within the meaning of the sales factor. Refer to Table 3, above.

the audited sales denominators.

The Tax Commission believes that the California SBE in *Merrill Lynch* misapplied the U.S. Supreme Court precedents. Distortion analysis does not stop whenever the difference in average factor between the parties is less than 250%.[40] Instead, it focuses on the relationship between the gross receipts and the net income. Combining of high gross/low net lines of business with normal gross/normal net lines of business may distort the overall apportionment, if the overall gross receipts do not mirror how the taxpayer's overall taxable income is generated. Statutory double weighting of the sales factor in arriving at the average factor, as Idaho has required since in 1994, can aggravate the distortion.

In this respect, the distortion analysis of a treasury function, such as that in *Pacific Telephone*, is the same as that for an active trade or business, as in *Merrill Lynch. Merrill Lynch* was decided as it was because the FTB failed to prove distortion by failing to develop the relevant facts. Given the distortion statistics set out above in Tables 3 and 4, and the lack of net profit information from the taxpayer despite a written request, it is appropriate here to follow the *Pacific* analysis and remedy, distinguishing *Merrill.*

Reasonableness of remedy

The statute requires that the result be "reasonable." No Idaho case has interpreted the reasonableness requirement. But the Oregon Supreme Court has interpreted reasonableness to have three elements:

(1) the division of income fairly represents business activity and if applied uniformly would result in taxation of no more or no

[40] In the *Union Pacific* case, although the Idaho Supreme Court's opinion does not mention it, the difference between the parties' apportionments was in the range of 5% to 7%.

less than 100 percent of taxpayer's income;

(2) the division of income does not create or foster lack of uniformity among UDITPA jurisdictions; and

(3) the division of income reflects the economic reality of the business activity engaged in by the taxpayer in [the taxing state].[41]

The Tax Commission is satisfied that the solution reached here would not result in double taxation, unless the taxpayer could prove that it reported the return of capital element as gross receipts in its headquarters state return. No such contention has been made. By properly analyzing and following *Pacific* and *Merrill*, the Tax Commission enhances uniformity with other UDITPA states.

Most importantly, the result here reflects economic reality. The huge sums of return of capital flowing to the taxpayer from the sales transactions are simply a return of the taxpayer's own money. The weighting of these transactions in the apportionment formula should bear some proportionality to their contribution to the net income. To do otherwise would allow the tail of the trading business to wag the dog of the bulk of the taxpayer's profits.

[REDACTED] issue

The [Redacted] distribution was included in the taxpayer's federal taxable income for the year ending [Redacted]97. The Idaho income tax law presumptively starts the calculation with federal taxable income, making only those modifications that are specifically authorized in the Idaho Code. The taxpayer cites no authority for a modification that would subtract the DISC deficiency distribution. The Tax Commission affirms the auditors' treatment of this issue.

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[41]Twentieth Century-Fox Film Corp. v. Dep't of Rev., 700 P.2d 1035, 1043 (Or. 1985).

Expenses of foreign subsidiaries

The taxpayer argues that the expenses paid by the domestic parent for the foreign subsidiaries must be allowed under Idaho Code § 63-3027(t)(ii), which provides for adjustments to the book income of the foreign subsidiaries as needed to conform that book income to the tax accounting standards applied to domestic corporations under the IRC. The taxpayer argues that the "salary pension payments" in question would be deductible if the foreign subsidiaries were U.S. corporations.

It is well established that the taxpayer has the burden of proving its entitlement to exemptions, deductions, and credits. *E.g., Old West Realty v. Idaho State Tax Comm.,* 110 Idaho 546 (1986). Here, the claimed deductions have not been documented, and the reason why they were paid by the parent has not been explained. The taxpayer cites no authority for the proposition that one domestic corporation may deduct payments made by another domestic corporation.

In the absence of documentation and authority, the Tax Commission affirms the auditors' treatment of this issue.

CONCLUSION

WHEREFORE, the Notice of Deficiency Determination dated May 4, 2001, is hereby MODIFIED, and as so modified, it is AFFIRMED and MADE FINAL, and the claim for refund is DENIED.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest (computed through 12/16/02)(interest runs at $3.55 per day):

YEAR	TAX	PENALTY	INTEREST	TOTAL
[Redacted]96	$ (2,002)	$ 0	$ (981)	$ (2,983)
[Redacted]97	17,822	0	7,192	25,014
[Redacted]98	2,683	0	861	3,544
			TOTAL DUE	$25,575

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

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this ________ day of ___________________, 2002.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _______________, 2002, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No. [Redacted]

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