

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 15955
[REDACTED]	)	
Petitioner.	)	DECISION
	)	
	)	

---

On August 21, 2001, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted]. (the “taxpayer”), proposing additional income taxes, penalties, and interest for tax years ending 12/31/96, 12/31/97, 12/31/98, and 12/31/99 in the total amount of \$44,241.

On August 30, 2001, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on February 19, 2002.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision AFFIRMING the Notice of Deficiency Determination. After resolving certain minor issues of computation, the issue for decision is whether, in the years in issue, the taxpayer was a unitary business that should have filed a combined Idaho income tax return. For the reasons set forth below, the Tax Commission answers this question in the affirmative.

**Facts**

The taxpayer is a family-owned group of corporations, almost all of the top officers of which are men with the same surname. The taxpayer’s web site gives a thorough summary of the company’s history, which is augmented by documents gathered by the Tax Commission’s auditors. Domestically, the taxpayer’s companies fall into two major categories: Tree trimming for different types of customers (utilities, cities, and railroads); and other services for those same types of customers (for example, underground construction, overheating detection, operation of “call before you dig” phone lines, and several more, all for the utility industry).

Centralized purchasing of trucks through an in-house dealership “provides cost and supply advantages.” The company provides centralized titling of all the vehicles in its U.S. operations (per 10/11/99 board minutes). There is a centralized supervisory training program “to integrate ... the acqui[red] companies.” A major computer network is installed “[t]o improve the flow of information between [the taxpayer]’s diverse regional operations.”

Board minutes are unusually chatty and informal in tone. They show hands-on board involvement in operating details across the U.S. The family has assigned the individual board members to oversee a particular territory or subsidiary. The board gives each such person a pep talk to improve profitability in his territory or line of business. In the U.S. tree trimming line of business, the company refers to geographic regions by the surname of the responsible vice president.

Officers and directors of U.S. subsidiaries and the Canadian subsidiary are approved by the parent’s board. The officers and directors of the major U.S. subsidiaries are duplicates of the parent’s slates. But almost all of the officers of the largest Canadian subsidiary are Canadian, and none of the owning family is an officer of that Canadian subsidiary. Smaller Canadian subsidiaries, however, have family members as both officers and directors.

[Redacted].

The foreign operations are mentioned infrequently in the magazine, and are not included in consolidated numbers discussed at meetings of the board of directors. Minutes of

April 6, 1999 show an employee “returned from [country A] to run [a U.S. subsidiary], and we are rearranging our management in [country A] to achieve a larger market share and a better return.”

The corporate structure shows an investment company located in Delaware, receiving substantial royalties from the taxpayer parent company. The investment company carries a large receivable from affiliates on its books, so the royalty is accrued without being paid in cash.

In Idaho, the parent company filed separate returns, with pro forma separate federal returns attached. The separate returns reflected the annual deduction for royalty expense paid to the investment company.

The taxpayer’s preparer admitted that the taxpayer files a combined report in another large state. The auditors placed the taxpayer on a worldwide combined basis.

The auditors imposed a negligence penalty of 5%, citing our Administrative Rule 410.02.k, which lists failure to produce records to substantiate items on the return as an example of negligence.

The protest argues that each geographic region is independent in its daily operations, and it is not required to use a central source for purchasing. There are no common communications facilities and no intercompany charges. Each subsidiary’s training is unique. The officers and directors, while they overlap, have very little day-to-day control. Each Sponsor<sup>1</sup> promotes, compensates, and fires his staff and is responsible for their training. Intercompany transfers of personnel are infrequent.

The protest asks that the combination be recast as “water’s edge.”

---

<sup>1</sup> Company literature and minutes refer frequently to “Sponsors,” who are a layer of upper management that may or may not be the same as corporate vice presidents.

Finally, the protest supplement asks for waiver of the negligence penalty, on the ground that the preparer of the auditors' unitary questionnaire did the best she could to answer it, given the breadth of the records and people she had to review.

In response to questions after the informal conference as to the amount of study made by the taxpayer's tax staff of the unitary business principle, attendance at seminars on that topic, and subscriptions to tax periodicals, the taxpayer's representative stated that the taxpayer's staff merely read the instructions to the forms before preparing them.

### Analysis

#### **Unitary combination**

Idaho Code § 63-3027(t) provides that two or more corporations may be considered a single corporation for income tax purposes, provided more than 50% of the voting stock of each of them is owned directly or indirectly by a common owner or owners, and such treatment is necessary to accurately reflect income. The Idaho Supreme Court has interpreted this statute to require combined reporting by a unitary business. E.g., Albertson's, Inc. v. State, Dept. of Rev., 109 Idaho 810 (1984).

Unitary business is a concept of constitutional law under the Commerce and Due Process Clauses. A state may tax the multistate income of a non-domiciliary corporation if there is both a "minimal connection" between the interstate activities and the taxing state and a rational relationship between the income attributed to the taxing state and the in-state value of the corporate business. A state need not attempt to isolate the in-state income producing activities from the rest of the business. The state may tax an apportioned share of the multistate business if the business is unitary. But the state may not tax the business' income that is "derived from unrelated business activity" or a "discrete business enterprise." Allied-Signal, Inc. v. Director, Div. of Tax., 504 U.S. 768, 772-773 (1992)(citations and internal quotation marks omitted); Albertson's, supra, 106 Idaho at 815 n.4.

In 1965, Idaho adopted with slight modification the Uniform Division of Income for Tax

Purposes Act (UDITPA), Idaho Code § 63-3027. The Act contains a formula for determining the portion of a corporation's total income from a multistate business which is attributable to Idaho and therefore subject to Idaho's income tax.

Combined reporting is a refinement of the apportionment principle. Its purpose is to permit application of the UDITPA apportionment formula to a single business enterprise that is conducted by means of separately incorporated entities. In an economic sense, such a business is no different from a similar business composed of a single corporation with several separate divisions. For tax reporting, such businesses should be treated the same. Combined reporting can be required only in the case of a unitary business. When the Tax Commission has found that a subsidiary is part of the taxpayer's unitary business, the taxpayer has the burden of proving that the finding is incorrect. Albertson's, supra, 106 Idaho at 814-815. Here, the auditors have so found, and the taxpayer has the burden of disproving the finding.

Among the tests of unity is whether "the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state;" if it does, the business is unitary. Edison Cal. Stores v. McColgan, 30 Cal. 2d 472, 481, 183 P.2d 16, 21 (1947), quoted at 106 Idaho at 815. Here, the core tree trimming business provides customers for the other lines of business, showing contribution and dependence.

Another test asks "whether contributions to income result from functional integration, centralization of management, and economies of scale." F. W. Woolworth Co. v. Taxation & Rev. Dept., 458 U.S. 354, 364 (1982), quoted at 106 Idaho at 816. Here, the owning family dominates upper management and there is central purchasing and titling of vehicles. These show centralization of management, functional integration, and economies of scale.

The Tax Commission concludes that the taxpayer and its subsidiaries are a single unitary business under the Constitution. This finding is reinforced by IDAPA 35.01.01.040, the Idaho

administrative rule on Unitary Business. Part .06 of that Rule provides in part that the presence of “same type of business,” when “all of [the taxpayer’s] activities are in the same general line,” creates a “strong presumption that the activities of the concern constitute a single trade or business.” Here, the company is engaged in a variety of services to the utility industry, which is “in the same general line.”

Accordingly, the Tax Commission finds that the taxpayer was engaged in a unitary business during the years in issue and is therefore required to file a combined report.

Permission to file on a water’s-edge basis is denied because Idaho Code § 63-3027C(a) provides that a “water’s-edge election shall be made in the original return for a year . . . .” The original returns here were separate returns, and contained no such election.

### **Negligence penalty**

Idaho Code § 63-3046(a) imposes the negligence penalty if “any part of [the] deficiency is due *to* negligence or disregard of rules and regulations . . . .” Here, Idaho law described above for many years has required filing by unitary businesses on a combined basis. The taxpayer, despite filing that way with at least one other state, presented no evidence of any attempt to analyze the facts under the governing legal standards. The penalty is therefore affirmed.

### **Conclusion**

WHEREFORE, the Notice of Deficiency Determination dated August 21, 2001, is hereby APPROVED, AFFIRMED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalty, and interest (computed through 07/19/02)(interest runs at \$7.46 per day):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/96	\$ 6,691	\$ 335	\$2,502	\$ 9,528
12/31/97	12,915	646	3,706	17,267
12/31/98	9,716	486	2,038	12,240
12/31/99	4,817	241	660	<u>5,718</u>
			TOTAL DUE	<u>\$44,753</u>

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

---

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]

---

ADMINISTRATIVE ASSISTANT 1