

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 18045
)
Petitioner.) DECISION
)
_____)

On February 11, 2004, the Income Tax Audit Division of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted]. and Subsidiaries (hereinafter referred to collectively as “taxpayer”), asserting additional income tax, penalty, and interest in the amount of \$455,699 for the 1998 through 2000 taxable years. On April 13, 2004, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer elected not to schedule this matter for an informal hearing before the Commission. The Tax Commission, having reviewed the file, hereby issues its decision upholding the Notice of Deficiency Determination.

I.

SUMMARY OF THE FACTS AND STATEMENT OF THE ISSUES

[Redacted]. is the parent corporation of a worldwide unitary financial services company. During the years at issue (1998 – 2000), [Redacted] divided its operations into four segments: (1) the [Redacted] segment, (2) the [Redacted] segment, (3) the [Redacted] segment, and (4) the [Redacted] segment. 2000 Form 10-K405, p. 2 (electronic copy accessed 4/12/05). These four operating segments are described in the taxpayer’s SEC filings as follows:

The Company’s [Redacted] segment includes a [Redacted] encompassing, among other things [Redacted]. The businesses included in the Company’s [Redacted] segment serve [Redacted] in developed and emerging markets throughout the world. These businesses provide, among other things, [Redacted]. [Redacted] includes [Redacted]. . . . The [Redacted] segment includes the Company’s [Redacted] plan or plans of a similar nature.

Id.

In 2002 the Idaho State Tax Commission's Income Tax Audit Division conducted an audit of [Redacted], and its subsidiaries. The audit resulted in a number of audit adjustments. The taxpayer has protested two of those adjustments. First, the taxpayer asserts that the audit staff incorrectly computed the Idaho sales factor. Next, the taxpayer requests that some or all of the penalty and interest set out in the Notice of Deficiency Determination be abated. We will address these two issues in the order presented.

II.

OPINION

A. The Audit Staff Correctly Determined the Taxpayer's Idaho Sales Factor.

The first issue raised in this administrative protest relates to the Idaho sales factor calculation. The taxpayer asserts that the Idaho sales factor was incorrectly computed by the Commission's audit staff. More specifically, the taxpayer makes the following allegation:

. . . [W]e are protesting that part of the audit assessment in which the sales apportionment for [Redacted] has been adjusted. The auditor changed the factor from a gross receipts basis to a gross income basis.

Idaho Code Section 63-3027(a)(5) states: "Sales means all gross receipts of the taxpayer not allocated under subsections (d) through (h) of this section." Also, Rule 35.01.01.525 states: "Sales means all gross receipts of a taxpayer not allocated as nonbusiness income. The sales factor for each trade or business of the taxpayer includes all gross receipts derived by the taxpayer from transactions and activity in the *regular course of that trade or business*". (emphasis added)

Gross receipts for the brokerage and securities trading business includes all payments accrued or received. It should also be noted that [Redacted] has used gross receipts in both the numerator and denominator of the apportionment factor.

In summary, we feel the use of gross receipts by [Redacted] in their sales apportionment factor is correct and should not be adjusted.

Letter from [Redacted] to [Redacted] dated November 19, 2004.

The taxpayer correctly points out that Idaho Code § 63-3027(a)(5) defines the word “sales” as all gross receipts of the taxpayer not allocated as nonbusiness income. The taxpayer also correctly points out that under the standard Idaho apportionment calculation, the sales factor is determined by dividing the total sales of the taxpayer taking place in Idaho during the taxable year by the total sales of the taxpayer taking place everywhere during the taxable year. Thus, under the standard Idaho apportionment calculation, [Redacted] has a good argument that the total gross receipts from its [Redacted] subsidiary should be used in computing the Idaho sales factor.¹ However, Idaho Code § 63-3027(s) allows the Tax Commission to require a taxpayer to use an alternative apportionment method in those situations where the standard apportionment formula does not fairly represent the extent of the taxpayer’s business activity in this state. The Tax Commission, under the authority of this alternative apportionment provision, has adopted an alternative apportionment method that applies to “financial institutions.” See Income Tax Administrative Rules 580.01.g and 582.01, IDAPA 35.01.01.580.01.g and 35.01.01.582.01 (2005). Under this alternative apportionment method, only the **net gains** from certain investment and trading activities are included in the sales factor. See MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions, Section

¹ *But see General Motors Corp. v. Franchise Tax Bd.*, 16 Cal.Rprt.3d 41 (Cal. Ct. App. 2nd Dist. 2004) *modified on denial of reh'g*, 2004 WL 1682904, *rev. granted*, 99 P.3d 1, 19 Cal.Rptr.3d 823 (2004). In *General Motors Corp.*, the California Court of Appeals, 2nd District, held that the return of principal from “repurchase agreements and maturities” did not meet the definition of the term “sales” under the California income tax statutes. “Since the transactions are not sales, the return of capital is not includable in the sales factor as ‘gross receipts.’” *Id.* at 52. (The case is currently before the California Supreme Court on a petition for review). *In Accord, Walgreen Arizona Drug Co. v. Arizona Dept. of Revenue*, 97 P.3d 896, 899 (Ariz. Ct. App. 2004) (return of principal from short-term investment transactions does not qualify as a “gross receipt” for purposes of the Arizona sales factor.) Given the Commission’s holding in this Decision, we do not need to decide whether the [Redacted] investment and trading activities are properly characterized as “sales” as that term is used in the Idaho sales factor.

3(m)(1).² The Tax Commission’s audit staff used this special industry regulation in computing the Idaho sales factor of [Redacted] and subsidiaries.

Idaho Income Tax Administrative Rule 582.02 defines the term “financial institution” as “a person that predominantly deals in money or moneyed capital in substantial competition with the business of national banks.” IDAPA 35.01.01.582.02 (2005). There is no question that [Redacted] and its unitary subsidiaries qualify as a “[Redacted]” under this definition. As a result, we find that the allocation and apportionment provisions set out in the MTC Recommended Formula for the Apportionment and Allocation of Net Income of [Redacted] apply. Further, the taxpayer has not provided any evidence or argument suggesting that the Commission’s audit staff incorrectly applied these [Redacted] apportionment and allocation provisions. Therefore, we have no alternative but to uphold the findings of the audit staff. *See Parsons v. Idaho State Tax Commission*, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986) (a State Tax Commission deficiency notice is presumed to be correct and the burden is on the taxpayer to show that the deficiency is erroneous).

B. Imposition of Interest and Penalty was Appropriate.

The second and final issue raised in this protest is whether some or all of the interest and penalty asserted in the Notice of Deficiency Determination should be abated. In its letter of protest, [Redacted] “request[s] that the penalty and interest portion of the deficiency be removed to reflect that the apportionment formulas used in the returns as filed were consistent with the overall method provided for corporations filing such returns and were not the result of an error or misapplication of the guidelines provided for calculating the apportionment formulas.” Letter of protest, pp. 1-2. After careful consideration, we decline the taxpayer’s request.

² This MTC model regulation has been incorporated by reference into the Idaho Income Tax Administrative Rules. See IDAPA 35.01.01.580.g (2005) and IDAPA 35.01.01.582 (2005).

Interest is imposed as a matter of law and cannot be waived. Union Pac. R. Co. v. State Tax Com'n, 105 Idaho 471, 476, 670 P.2d 878, 883 (1983). As a result, we have no choice but to uphold in total the interest that is owed on the tax deficiency. The penalties set out in Idaho Code § 63-3046, on the other hand, can be waived in appropriate circumstances. The penalty at issue in the present protest is the 25% nonfiler penalty set out in Idaho Code § 63-3046(c). The audit staff determined that four of the [Redacted] unitary subsidiaries that had an Idaho corporate income tax filing requirement during the years at issue had failed to file an Idaho return. *See* Notice of Deficiency Determination, Schedule 2400. The penalty was computed based on the amount of Idaho tax owed by those four unitary subsidiaries. Id. [Redacted] has provided no evidence or argument suggesting that this audit finding is incorrect. As a result, we find that [Redacted] has not provided sufficient grounds for abating any of the penalty imposed in the Notice of Deficiency Determination.

III.

ORDER

WHEREFORE, the Notice of Deficiency Determination dated February 11, 2004, is hereby APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$72,297	\$52	\$29,982	\$102,331
1999	156,617	605	53,440	210,662
2000	132,219	317	34,587	167,123
	Less Payments Received			(7,722)
	Less Interest on Payments, computed to 5/31/2005			<u>(528)</u>
	TOTAL AMOUNT DUE			\$471,866

Interest is calculated through May 31, 2005, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

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 _____, 2005.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE BY MAIL

I hereby certify that I have on this ____ day of _____, 2005, 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.
