

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 18873
[Redacted],)	
)	DECISION
Petitioner.)	
_____)	

This is a corporate income tax case. At issue is whether [Redacted] (taxpayer), a [Redacted] corporation headquartered in [Redacted], [Redacted], is required to include in its Idaho sales factor numerator sales it makes to businesses operating within the federally recognized [Redacted] and [Redacted] and owned by either the [Redacted] or an enrolled member of the Tribe.

The taxpayer, doing business as “[Redacted],” is a wholesale distributor of cigarettes and other tobacco products, as well as candy and miscellaneous snack foods. The taxpayer sells cigarettes and other products to various [Redacted] shops located on the [Redacted] and owned by either the [Redacted] or enrolled members of the [Redacted]. The company also makes sales in Idaho to [Redacted] retailers, but those sales are not at issue in this protest.

The State Tax Commission’s (Commission) Tax Discovery Bureau contacted the taxpayer who then voluntarily filed Idaho corporate income tax returns for 1999 through 2003.¹ The returns did not include in the Idaho sales factor numerator any of the sales to retail operations located [Redacted] and owned by [Redacted] or enrolled members of [Redacted]. The Commission auditor did not accept the returns as filed. The auditor included the disputed sales to [Redacted] retailers in the Idaho sales factor numerator, recalculated the tax owed, and prepared a Notice of Deficiency Determination (NOD).

¹ Effective January 1, 2000, the taxpayer elected Subchapter S corporation status. However, for the 2000 through 2003 tax years the taxpayer elects to report and pay the Idaho tax at the entity level as allowed by Idaho Code § 63-3022L(1).

On April 12, 2005, the Tax Discovery Bureau of the Idaho State Tax Commission issued the NOD to [Redacted] asserting additional income taxes, late-filing penalty, and interest in the amount of \$121,715 for tax years 1999 through 2003.² On June 14, 2005, the taxpayer filed a timely appeal and petition for redetermination. An informal conference was held on November 29, 2005. This Decision is the result.

States may tax income of non-residents earned within the state. See, e.g., *Shaffer v. Carter*, 252 U.S. 37 (1920). As set forth in Idaho Code § 63-3027, various formulae may be used to determine the amount of income earned in Idaho. In this case, the taxpayer's total income is multiplied by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales factor, divided by four (4). Proper determination of the sales factor is the issue in this case. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer *in the state* during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. [Redacted] maintains it is impermissible to include sales factor numerator sales made on the [Redacted] to [Redacted] or member-owned retail outlets because these sales were not made in the state. For ease of discussion, these sales will be referred to as [Redacted]

The taxpayer maintains it is improper to include Indian sales in the sales factor numerator because the reservations are outside Idaho. In fact, during the informal conference, the taxpayer's representative emphasized this point by stating that for Idaho to tax income derived from transactions or activities taking place within the [Redacted] would be akin to taxing income derived from transactions on activities taking place within [Redacted]. The taxpayer asserts

² There was an arithmetic error in the NOD. The "Total Due" amount did not include the amount shown due for the 1999 tax year. The correct "Total Due" was \$121,715.

support for this position is found in *Mahoney v. State Tax Commission*, 96 Idaho 59, 524 P.2d 187 (1973). The taxpayer also relies on Article 21, § 19 of the Idaho Constitution.

The Commission disagrees with the taxpayer's *Mahoney* analysis. *Mahoney* involved the Commission's jurisdiction to enforce the Idaho cigarette tax on the sale of cigarettes occurring on the [Redacted] Reservation. The cigarettes were owned and possessed by a member of the [Redacted] [Redacted] and were located at his [Redacted] tobacco shop for resale to both [Redacted] purchasers. The Commission seized the cigarettes because they did not have Idaho cigarette tax stamps. These stamps were required in order to sell cigarettes in Idaho. The [Redacted] retailer filed suit in state district court. The district court held that Idaho did not have jurisdiction to tax the [Redacted] sales of cigarettes by [Redacted]. The Commission appealed.

The Idaho Supreme Court affirmed the holding of the district court. The Court held that the Commerce Clause prevented Idaho from imposing its cigarette tax on the on-reservation sale of cigarettes by members of an Idaho tribe to [Redacted] purchasers. The Court stated that "the state is attempting to tax sales occurring within the boundaries of an [Redacted], not sales occurring within Idaho's domain." *Mahoney*, 96 Idaho at 190. Note the United States Supreme Court subsequently ruled contrary to *Mahoney*. In *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 100 S. Ct. 2069 (1980), the Court upheld a state's authority to tax cigarettes sold on a [Redacted] [Redacted] members when the legal incidence of the tax fell on the purchaser.

Colville notwithstanding, the taxpayer argues that sales made by a [Redacted] corporation on a reservation located in Idaho cannot be used to calculate Idaho corporate income tax because the sales are not within Idaho's domain. The taxpayer interprets *Mahoney's* "not within Idaho's domain" language to mean "not within Idaho." This is an interpretation *Mahoney* never intended

and does not bear. Ask any enrolled member of a [Redacted] who voted in a state or local election. The phrase “not within Idaho’s domain” is better understood to mean “not within Idaho’s jurisdiction.” This is clear from the context in which the phrase “not within Idaho’s domain” occurs. After first noting that the tax in question is on the retail sale of cigarettes, the Court said:

In this case, the state is attempting to tax sales occurring within the boundaries of an [Redacted] [Redacted], not sales occurring within Idaho’s domain. . . . To paraphrase *McClod* [*v. J.E. Dilworth Co.*, 322 U.S. 91, 93 S.Ct. 349 (1972)], a tax on sales made *by Indians* on Indian reservations involves an assumption of power by a state which the Commerce Clause was meant to end. That clause vested in Congress, not in the states, the power of taxing a transaction forming an unbroken process of commerce with the [Redacted]. . . . Here, as in *McClanahan* [*v. State Tax Commission of Arizona*, 411 U.S. 164, 93 S.Ct. 1257 (1973)], the tax imposed may be successfully resisted because “the state is totally lacking in jurisdiction.”

Mahoney, 96 Idaho at 62-63. (Emphasis added, citations omitted.)

Mahoney does not stand for the proposition that the [Redacted] in question are not in Idaho. It does stand for the proposition that state jurisdiction on the [Redacted] is subject to limitation. The question is whether the limitations on the state’s jurisdiction extend to prohibiting the state from considering on-reservation sales made by a [Redacted] or tribe when calculating the [Redacted] income tax liability. Certainly, *Mahoney* does not address this issue. *Mahoney* involved sales made by an [Redacted], not a [Redacted]. This makes all the difference.

Cotton Petroleum Corporation v. New Mexico, 490 U.S. 163, 109 S.Ct. 1698 (1989), involved a state severance tax. The Supreme Court noted that absent express Congressional limitation, states are free to impose a fairly apportioned tax on [Redacted] from activities taking place on a [Redacted]. In *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450, 115 S.Ct. 2214 (1995), the Supreme Court faced a claim that the income of [Redacted] members who

worked for the [Redacted], but who resided off the [Redacted], was sheltered from state taxation. The Court held that even on those facts the income was subject to state tax. In *Loveness v. Arizona Department of Revenue*, 963 P.2d 303, (Az. Ct. App. 1998), the Arizona Court of Appeals upheld the state's jurisdiction to impose income taxes on income earned by [Redacted] for services performed on an [Redacted].

Article 21, § 19 of the Idaho Constitution does not change the analysis. That section disclaims right and title to unappropriated public lands lying within [Redacted]. It further recognizes that those lands are subject to the jurisdiction and control of the United States. Nothing in the section places reservation lands outside the state.

The taxpayer has not demonstrated that the Idaho sales factor should exclude sales made on reservations in Idaho. The Notice of Deficiency Determination is upheld.

WHEREFORE, the Notice of Deficiency Determination dated April 12, 2005, is hereby CORRECTED to eliminate the arithmetic error discussed in footnote 2, and as so CORRECTED is 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>
1999	\$11,016	\$2,754	\$4,206	\$ 17,976
2000	22,703	5,676	6,858	35,237
2001	14,888	3,722	3,351	21,961
2002	18,339	4,585	2,949	25,873
2003	23,225	5,806	2,505	<u>31,536</u>
			LESS	(\$ 7,444)
			TOTAL DUE	<u><u>\$132,583</u></u>

Interest is calculated through January 31, 2006, 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 included with this decision.

DATED this ____ day of _____, 2006.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2006, 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.