BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of [Redacted] Petitioner.	)))))))	DOCKET NO. 19312 DECISION

INTRODUCTION

On December 15, 2005, the Corporate Income Tax Audit Division of the Idaho State Tax Commission ("Commission") issued a Notice of Deficiency Determination to [Redacted] ("taxpayer" or "[Redacted]"), for corporate income taxes due in the amount of $140,685 for the taxable years [Redacted] through [Redacted]. On February 9, 2006, [Redacted] filed a timely appeal and petition for redetermination. An informal conference was held June 1, 2006, at [Redacted] request. Thereafter, the taxpayer submitted additional evidence pursuant to questions and requests of the Commission. The Commission reviewed the information submitted and now issues a final decision.

FACTS

[Redacted] is a global leader in the [Redacted] industries. [Redacted] is currently ranked among the largest privately held corporations in the United States. [Redacted] employs about [Redacted] people in more than [Redacted] countries. [Redacted], a [Redacted] entrepreneur, was the founder and Chairman of the company until his death in [Redacted]. Mr. [Redacted]founded the [Redacted] in [Redacted] with a [Redacted] loan. [Redacted] proved to be right for the times and swept the nation in a wave of dramatic growth.

[Redacted] diversified from the t[Redacted] business when he purchased the [Redacted] [Redacted] in downtown [Redacted] in [Redacted]. [Redacted] became an international brand which now includes more than [Redacted] properties. [Redacted] is the first truly global company in the

[Redacted]industry with international management.

The specific transactions at issue in this appeal arise from the year [Redacted], when [Redacted]announced plans to merge its [Redacted] [Redacted] operations ([Redacted]) with the [Redacted] who owned another[Redacted] related company, [Redacted]. The partnership created one of the largest [Redacted] companies in the entire world.

The following, taken with some modification from [Redacted] February 9, 2006, letter requesting a redetermination of the Notice of Deficiency, is the history of this partnership. The recital of these facts is relevant to the issues presented in this appeal.

History of Transactions

One of [Redacted] subsidiaries, [Redacted] ("[Redacted]") owns the [Redacted] company [Redacted] ("[Redacted]"). [Redacted] in turn owns the [Redacted]. On March 1, 2000, [Redacted] made a "check-the-box" election for both [Redacted]and [Redacted] and treated these entities as disregarded branches for federal tax purposes.

[Redacted] entered the [Redacted] market in [Redacted] with the purchase of [Redacted], a retail [Redacted] chain of approximately [Redacted] stores. [Redacted] was engaged at the retail level selling [Redacted] to customers through its owned and franchised [Redacted] agencies. While the company had a [Redacted] focus, during the [Redacted] it also developed a business [Redacted] portfolio. In [Redacted], the business [Redacted] portfolio and assets were spun off leaving only the [Redacted] retail distribution business in [Redacted].

During the mid-[Redacted], the [Redacted] industry was dominated by companies that had not only [Redacted] agencies, but also [Redacted] and [Redacted]. It was determined that [Redacted] should acquire a [Redacted] in order to compete. [Redacted], the selected target company, was acquired in [Redacted]. [Redacted], had been formed in [Redacted] as a [Redacted]

company, before acquiring [Redacted].

After [Redacted] purchase in [Redacted] of [Redacted] and its integrated [Redacted] and [Redacted] businesses, [Redacted] entered into an agreement to integrate these [Redacted] companies with [Redacted], which owned the [Redacted]. The [Redacted] consisted of both [Redacted] and [Redacted] companies. [Redacted] and [Redacted] named the merged [Redacted] and [Redacted] companies [Redacted]. ("[Redacted]"). [Redacted], with their contribution of [Redacted] with the [Redacted] and [Redacted] assets and components, owned [Redacted] percent of the stock of [Redacted] as well as some negotiated clauses for approval rights over certain transactions, including [Redacted] ability to sell its interests in [Redacted] [Redacted] owned [Redacted] percent of the stock. [Redacted] was allowed three of the eight board of directors of the new [Redacted].

Sometime after [Redacted] [Redacted], as part of a business plan, pursued the purchase of another [Redacted] [Redacted] company named [Redacted]. [Redacted]'s partner, [Redacted], in order to comply with [Redacted] anti-monopoly regulations, negotiated with [Redacted] to divest itself of its interest in [Redacted]. It appears that [Redacted] voluntarily cooperated with [Redacted] in these endeavors. On [Redacted], [Redacted]. ("[Redacted]"), another [Redacted] subsidiary, purchased an option to buy [Redacted]'s [Redacted] percent of their ownership interest in [Redacted]. This purchase released [Redacted] from the negotiated clauses in the original merger of [Redacted] and [Redacted] including [Redacted]'s approval of [Redacted] divesting its [Redacted] ownership interests.

On [Redacted], [Redacted] sold all the stock of three subsidiaries representing its entire [Redacted] and [Redacted] [Redacted] related services businesses, [Redacted], to another company named [Redacted]. This sale left other [Redacted] related businesses in [Redacted]. After the sale a

dividend of the sale proceeds, less selling expenses and taxes, was declared and called the [Redacted] dividend.

On [Redacted], [Redacted] through [Redacted] sold its shares in [Redacted] to another company called [Redacted]. [Redacted] and [Redacted] retained their respective rights to the [Redacted] dividend respectively[Redacted] percent and [Redacted] percent. For U.S. tax purposes, [Redacted] and [Redacted] characterized the [Redacted] dividend from [Redacted] as proceeds on the sale of their respective interests in [Redacted]. The stock ownership in [Redacted] was recorded as an investment on the financial statements of [Redacted]. Based upon figures provided by [Redacted] on [Redacted], on a "Schedule of Nonbusiness Income," in monetary terms [Redacted]'s capital gain from the sale of its [Redacted] percent interest in [Redacted] was [Redacted]. [Redacted]'s capital gain from its sale of the [Redacted] percent option was [Redacted]. The sale of [Redacted] percent of [Redacted] by [Redacted] included the assets [Redacted] contributed to [Redacted] of [Redacted], [Redacted], and [Redacted].

In its protest of February 9, 2006, on page 4, [Redacted] wrote that it "never owned a majority of the stock in [Redacted] (except on the last day when the stock was purchased and immediately sold)." When the Commission asked [Redacted] for clarification of this issue in correspondence on July 21, 2006, they denied ever actually owning all of the company, if only for one day. It appears that at one point in time [Redacted] owned at least a majority of [Redacted]. [Redacted] treated the sale of [Redacted] as nonbusiness income on its tax returns.

Board Meeting Minutes

The Commission's audit staff reviewed various minutes from [Redacted] board meetings related to the [Redacted] transactions. According to [Redacted], minutes, the merger of [Redacted] and [Redacted] occurred to increase their [Redacted] interests. The merger consolidated three major

players of the [Redacted] market into a vertically integrated ([Redacted]) operation. The [Redacted] percent ownership interest in [Redacted] also gave [Redacted]leverage in discussions with other [Redacted]industry companies such as [Redacted] and [Redacted]. The [Redacted] merger included "negative" controls giving [Redacted] much more power than [Redacted] percent equity would normally have.

After the sale of its interests in [Redacted] the board minutes on [Redacted], reflect that the sale gave [Redacted] several opportunities for alliances and other potential advantages for the future.

[Redacted] minutes reflect non-competition agreements existed between the merged companies.

News Releases

[Redacted] issued a news release on [Redacted]. Therein, [Redacted] announced its intention to sell its [Redacted] percent interest in [Redacted] and that the sale would enable acceleration of [Redacted] and [Redacted] expansion plans. [Redacted] said the sale would enable it to "even more rapidly" move against its already aggressive growth plan in its other [Redacted] businesses and throughout the world. [Redacted] also said it had integrated the [Redacted] innovative programs and services, [Redacted] and [Redacted] into the United States market. After the sale [Redacted] utilized these services in the [Redacted] to facilitate [Redacted] as a [Redacted].

Informal Hearing Process

During the informal hearing process, the Commission asked [Redacted] a question regarding the integrated [Redacted] and [Redacted]. [Redacted] responded on June 6, 2006, that both programs do continue to be offered by [Redacted] franchisees, but are very immaterial and are not strategic [Redacted] business activities. However, in [Redacted] Board minutes on [Redacted], [Redacted]'s Board, while analyzing [Redacted] issues, made a special note to mention [Redacted].

The board noted that [Redacted] "had substantially underperformed and that net treasury interest contributed a loss of over [Redacted] million at the [Redacted] level." The minutes went on to reflect that [Redacted] and [Redacted] operations continued to lose money as well as reiterating the [Redacted] underperformance.

On [Redacted], more discussion involved the possibility of increasing [Redacted]'s ownership in [Redacted] to [Redacted] percent as well as more collaborative opportunities with [Redacted].

ISSUES

[Redacted] argues that the gains from the sale of interests in [Redacted] should be treated as nonbusiness income. [Redacted] argues that it is not in the business of selling stock or stock options. [Redacted] argues that no transactional or functional integration occurred due to the [Redacted] transaction. [Redacted] states in its February 9, 2006, protest, on page 4, that, "the potential to expand upon many business relationships did exist. However, the realization of this potential simply did not occur." [Redacted] provides several cases and arguments in its analysis that will be addressed in this decision.

LAW AND ANALYSIS

Statutes and Administrative Rules

Business and Nonbusiness Income

In 1965 Idaho adopted, with slight modification, the Uniform Division of Income for Tax Purposes Act (UDITPA). That uniform act, as modified, is found at Idaho Code § 63-3027. As described by the Idaho Supreme Court:

> The Act contains rules for determining the portion of a corporation's total income from a multistate business which is attributable to this state and therefore subject to Idaho's income tax. In general, UDITPA divides a multistate corporation's income into two groups:

> business income and non-business income. Business income is apportioned according to a three factor formula, while nonbusiness income is allocated to a specific jurisdiction.

American Smelting & Ref'g Co. v. Idaho St. Tax Comm., 99 Idaho 924, 927, 592 P.2d 39, 42 (1979) (citations to statute omitted), *rev'd on other grounds*, ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307, 102 S.Ct. 3103 (1982).

Under Idaho's tax laws, business income is defined as all "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitute integral or necessary parts of the taxpayer's trade or business operations." Idaho Code § 63-3027(a) (1). Nonbusiness income is all income other than business income. Idaho Code § 63-3027(a)(4).

There is a strong presumption under Idaho law that income derived from stock or other securities is business income. Idaho Code § 63-3027(a)(1) ("Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitute an integral part of the taxpayer's trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary.") Thus, the burden is clearly on the taxpayer to establish that the gains and losses from the sale of stock or other securities is nonbusiness income.

Constitutional Considerations Regarding Business Income Determinations of Investments

Once the sale of stock is determined to be business income under the Idaho statutes, the next step in the analysis is to consider the relevant federal constitutional limitations. In a series of cases culminating in Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 112 S.Ct. 2251 (1992),

the United States Supreme Court provided an analytical framework for determining the constitutional restraints on state apportionment of income.1

The starting point is the recognition that the Due Process Clause and the Commerce Clause of the United States Constitution preclude states from taxing nondomiciliary corporations on income "derived from unrelated business activity which constitutes a discrete business enterprise" with no connection to the taxing state. Allied-Signal at 773, 112 S.Ct. at 2255 (*quoting* Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 224, 100 S.Ct. 2109, 2120 (1980)) (internal quotations and modifications omitted).

> The Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities -- even on a proportional basis -- unless there is a " 'minimal connection' or 'nexus' between the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the state and the intrastate values of the enterprise.' " *Exxon Corporation v. Wisconsin Dept. of Revenue*, 447 U.S., at 219-220, 100 S.Ct., at 2118, *quoting Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S., at 436, 437, 100 S.Ct., at 1231. At the very least, this set of principles imposes the obvious and largely self-executing limitation that a State not tax a purported "unitary business" unless at least some part of it is conducted in the state. See *Exxon Corp*., 447 U.S., at 220, 100 S.Ct., at 2118; *Wisconsin v. J.C. Penney Co*., 311 U.S. 435, 444, 61 S.Ct. 246, 249, 85 L.Ed. 267 (1940).

Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 165-166, 103 S.Ct. 2933, 2940 (1983).

The Supreme Court provided some insight into the breadth of the constitutional limitation on apportionment of income in Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 100 S.Ct. 1223 (1980), where the Court stated that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Id.* at 439, 100 S.Ct. at 1232. In short, income derived from the unitary

1 The alluded to cases are Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 100 S.Ct. 1223 (1980); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 102 S.Ct. 3103 (1982); F.W. Woolworth Co. v. Taxation and Revenue

business of the taxpayer may be apportioned among the various states in which the taxpayer conducts its unitary business. Such apportionment is consistent with the federal limitations found in the Due Process and Commerce clauses. As described by one commentator:

> Under the unitary business principle, if a taxpayer is carrying on a single "unitary" business within and without the state, the state has the requisite connection to the business' out-of-state activities to justify the inclusion of all of the income generated by the combined effect of the out-of-state and in-state activities in the taxpayer's apportionable tax base. By the same token, if the taxpayer's income-producing activities carried on within the state are not unitary with its income-producing activities carried on elsewhere, the state is constitutionally constrained from including the income arising from those out-of-state activities in the taxpayer's apportionable tax base. Although it was not until 1980 that the Court declared that "the linchpin of apportionability in the field of state income taxation is the unitary business principle," this principle, as the Court recognized, was not "new." Indeed, even at the time it had "been a familiar concept in our tax cases for over sixty years."

Walter Hellerstein, MULTISTATE TAX PORTFOLIOS § 1190:02.A.1 (Footnotes omitted).

In Allied-Signal the Court reaffirmed the unitary business principle as the linchpin of apportionability. According to the Court:

> [T]he unitary business rule is a recognition of two imperatives: the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income which cannot in fairness be attributed to the taxpayer's activities within the State.

Allied-Signal at 780, 112 S.Ct. at 2259.

The Allied-Signal Court then went on to describe the two occurrences where apportionment of income from intangibles will be allowed under the unitary business principle. First, apportionment will be permitted if there is unity between the payor and the payee. That is, apportionment is permitted if the payor and the payee are engaged in the same unitary business. It was this payor-payee unity that was at issue in Mobil (unity found), ASARCO (unity not found), and F.W. Woolworth (unity not found).

Dept., 458 U.S. 354, 102 S.Ct. 3128 (1982); Container Corporation of America v. Franchise Tax Bd., 463 U.S. 159,

Payor-payee unity is dependent on the relationship of the payor and payee corporations. The analysis focuses on the tried and true indicia of unity: (1) functional integration, (2) economies of scale, and (3) centralized management.

The second occurrence upon which apportionment of income from intangibles will be permitted is if the capital transaction from which the income is derived "serves an operational function" as opposed to an "investment function." *Id.* at 788, 112 S.Ct. at 2263 - 2264. "The essential question under the operational-function test is whether the intangible asset is part of the corporate taxpayer's own unitary business, not whether two separate corporations are engaged in a common enterprise." Walter Hellerstein, State Taxation of Corporate Income From Intangibles: Allied-Signal And Beyond, 48 Tax L. Rev. 739, 791 n.315.

The United States Supreme Court in Allied-Signal clearly indicates that a taxpayer can derive apportionable unitary income from an operational transaction even though there is no unity between the payor corporation and the payee corporation.

The Court left this operational-function test largely undefined; however, the Court provided one practical example of operational unity. According to the Court, "a State may include within the apportionable income of a nondomiciliary corporation the interest earned on short-term deposits in a bank located in another state if that income forms part of the working capital of the corporation's unitary business, notwithstanding the absence of a unitary relationship between the corporation and the bank." *Id.* at 787-788, 112 S.Ct. at 2263. Thus, income earned on the investment of idle working capital can constitutionally be apportioned among the various states in which the corporation conducts its unitary business operations.

The Court also gave another indication of the breadth of this operational-function test when it

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103 S.Ct. 2933 (1983); and Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 112 S.Ct. 2251 (1992).

cited footnote 19 of Container Corporation of America v. Franchise Tax Bd. In footnote 19 of Container Corp., Justice Brennen, writing for the majority, stated that "[a]s we made clear in another context in *Corn Products Refining Co. v. C.I.R.*, 350 U.S. 46, 50-53, 76 S.Ct. 20, 23-24, 100 L.Ed. 29 (1955), capital transactions can serve either an investment function or an operational function." Container Corp. at 180 n.19, 103 S.Ct. at 2948 n.19. It is this distinction between investment and operational functions that is at the heart of the operational-function test set forth in Allied-Signal. In general terms, if a capital transaction serves an operational function, the income derived from the transaction will be treated as part of the corporation's unitary business and is subject to apportionment. Conversely, if the transaction serves an investment function, the income derived from the taxation cannot be taxed by a nondomiciliary state unless (1) the investment transaction took place, at least in part, in that state, or (2) payor-payee unity exists.

Another important point that can be gleaned from the language in footnote 19 of Container Corp. is that transactions other than the short-term investment of idle working capital may meet the operational-function test. The fact that the Court cites with approval the Corn Products Co. v. Commissioner decision is key. As explained by Professor Hellerstein:

> In *Corn Products*, the Supreme Court held that a company engaged in converting corn into syrup and other products realized ordinary income and loss on the sale of corn futures even though such futures were not literally excluded from the "capital asset" definition under I.R.C. § 1221. Because the taxpayer's transactions in corn futures were designed to protect its manufacturing operations against increases in the cost of its principal raw material and to assure a ready source of supply of corn if needed, the Court held that the resulting profits and losses should be characterized consistently with Congress' perceived intent "that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss." *Corn Products*, 350 U.S. at 52.
>
> The case spawned the doctrine under which gain or loss from the sale of intangible assets, frequently stock in other corporations, was held to be ordinary gain or loss because the asset was "bought and kept

> not for investment purposes, but only as an incident to the conduct of the taxpayer's business." *John J. Grier Co. v. United States*, 328 F.2d 163, 165 (7th Cir. 1964). . . .
>
> Income from intangible assets falling under the Corn Products doctrine thus would be apportionable under the operational-function test. . . .

Hellerstein, State Taxation Of Corporate Income From Intangibles: Allied-Signal and Beyond, 48 Tax L. Rev. 739, 793-94 n.319 (emphasis added).

Analysis of the Law to the Facts

[Redacted]

Idaho Code § 63-3027 sets forth two separate and independent definitions of the term "business income." Union Pacific v. Idaho State Tax Com'n., 136 Idaho 34, 28 P.3d 375 (2001). According to the Idaho Supreme Court, the first definition for business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business." *Id.* at 38 – 39, 28 P.3d at 379 – 380. The second definition of business income includes "income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitute integral or necessary parts of the taxpayer's trade or business operations." *Id.*

These two separate definitions are commonly referred to as the "transactional test" and the "functional test." The transactional test is concerned with income arising from the ordinary course of the taxpayer's trade or business operations. In contrast, the functional test is concerned with income derived from property that is utilized in or otherwise directly connected with the taxpayer's trade or business operations. *Id.* at 38 – 39, 28 P.3d at 379 – 380.

There is no requirement under the functional test that the income arise from transactions and activities in the regular course of the taxpayer's trade or business. *Id.* at 39, 28 P.3d at 380. The key

determination is whether the acquisition, management, or disposition of the property was directly connected with the taxpayer's business operations. American Smelting at 931, 592 P.2d at 46 ("business income includes . . . income from tangible and intangible property if that property has the requisite connection with the corporation's trade or business."). Property that is not directly connected to the taxpayer's trade or business operations, such as passive investment property, does not generate business income. As pointed out in the American Smelting case:

> In our view, in order for such income to be properly classified as business income there must be a more direct relationship between the underlying asset and the taxpayer's trade or business. The incidental benefits from investments in general, such as enhanced credit standing and additional revenue, are not, in and of themselves, sufficient to bring the investment within the class of property the acquisitions, management or disposition of which constitutes an integral part of the taxpayer's business operations. This view furthers the statutory policy of distinguishing that income which is truly derived from passive investments from income incidental to and connected with the taxpayer's business operations.

Id. at 933, 592 P.2d at 48. The important distinction under the functional test is whether the property was directly connected with the taxpayer's business activity or whether it was merely a passive investment.

The Audit Division made the business income determination based on [Redacted] acquiring, managing, and disposing of the stocks and the option to purchase stocks as an integral or necessary part of [Redacted]'s [Redacted] related business.

The record before the Commission demonstrates the gains received by the Petitioner to satisfy both the transactional test and the functional test. The gains at issue are directly connected with the taxpayer's trade or business. The stocks from [Redacted] were directly related to the Petitioner's business in the [Redacted] industry. Through [Redacted] the Petitioner gained greater entrance into the [Redacted] international market and made alliances it may not have otherwise

reached.

Board minutes show that [Redacted] invested in [Redacted] with the intent to integrate. [Redacted] owned a [Redacted] percent (purchased in [Redacted]) ownership in [Redacted] and ownership of an option to purchase the other [Redacted] percent (purchased in [Redacted]) of [Redacted]. The option to purchase was unusual because it was valued per share only slightly less than the [Redacted] percent stock. The [Redacted] percent stock in [Redacted] sold for [Redacted], while the option to purchase the remaining [Redacted] percent sold for [Redacted], meaning that [Redacted] owned in effect more than just an option to purchase. According to the Board the [Redacted] percent ownership had a greater value than [Redacted] percent due to negative controls over the company. These negative controls would have been partly exerted by three of the eight Board member seats occupied by [Redacted] representatives.

The services [Redacted] and [Redacted] from [Redacted] were integrated into [Redacted]'s [Redacted] [Redacted] markets. [Redacted] says these services were insignificant; yet they were mentioned in press releases for [Redacted] and [Redacted] was of particular operational concern to [Redacted] due to its underperformance and resulting losses. The board minutes reflect an interest in how [Redacted] is performing as well as other parts of [Redacted]. Along with these discussions are also discussions of [Redacted]acquiring a greater ownership of [Redacted] and making greater partnerships with [Redacted]. Unlike passive investments that have no relation to the day-to-day business operations of [Redacted], the [Redacted] issues pertain to their related [Redacted] industry interests, partnerships for growth of the business, and concerns of how specific operations are performing in the scheme of the [Redacted] industry. In contrast to [Redacted]'s current opinion that [Redacted] is insignificant, at the time it resulted in a [Redacted] loss it was not insignificant. [Redacted]'s press releases did not treat [Redacted] and [Redacted]as insignificant, but instead

integral and necessary parts of the business[Redacted] continues to use these services in their business today.

As part of the [Redacted] and [Redacted] deal that created [Redacted], [Redacted] included the assets of [Redacted], [Redacted], [Redacted] and [Redacted] including assets of [Redacted] operators, hundreds of [Redacted] retail stores and [Redacted]. These were business assets when sold and thus business income.

It appears likely that [Redacted], the other company [Redacted] associated with to purchase [Redacted], continued alliances with [Redacted] after the sale along with the company that purchased [Redacted], [Redacted]. See, [Redacted]. The pursuit of these alliances with other companies resulting from the management, acquisition, and sale of the stock represents more than a passive investment.

Due to the obvious purchase, development, and subsequent sale of [Redacted]'s interest in [Redacted] an argument can be made that [Redacted]made it their business and was in the business of buying companies in order to further its business objectives and advance itself in further markets. The purchase of [Redacted] was not just an investment. The gains resulted from the disposition of 'core' parts of its business that were an integral or necessary part of the taxpayer's trade or business operations and were directly connected with the taxpayer's unitary business operations. It also does not appear all transactions between [Redacted] and [Redacted] could have been at arm's length considering the alliances made from the purchase, management, and sale of [Redacted].

Occidental Analysis

[Redacted]cited the case of Occidental Petroleum, 193 WL 15505 (1983 Cal.St.Bd.Eq.), to advance the position that the sale of [Redacted] should be treated as nonbusiness income. If we were in California and assuming Occidental Petroleum is controlling precedent in California that

would be a more compelling argument, but still not enough under the facts here. In Occidental, the California State Board of Equalization decided "whether the gains and losses several members of Occidental's unitary group realized from sales of stock in affiliated and unaffiliated corporations constituted business income apportionable by formula or nonbusiness income specifically allocable to the commercial domicile of the respective corporate shareholder." Id. at pp 2-3. The stock of five different corporations was in question in Occidental. All of the stock sales intended to advance Occidental's "concerted effort to expand and consolidate its basic unitary business involving natural resources and energy sources." Id, at p. 6. Three of the stock sales were determined to be business income. The other two were determined to be nonbusiness income because "at no time did they possess more than the potential for actual integration into appellant's ongoing business, and we believe that mere potential is insufficient to support a finding that the gains on these sales were business income under the functional test." Id., at p. 9. Furthermore, "the lack of integration" precluded a finding that the sales were in the ordinary course of business and Occidental was not in the business of buying and selling this type of company. Id. at pp. 9 and 10.

The two sales in Occidental that the Court deemed were not business income were the sales of Tenneco and Island Creek Coal Co. The Court in Occidental found that neither Tenneco or Island Creek Coal Co. had integrated with Occidental at the time they were sold and the sales were not "transactions and activity in the regular course" of Occidental's unitary business. Id at pp. 7 and 8.

Tenneco and Island Creek Coal Co. were both transactions that were secondary to other targeted Occidental transactions.

Occidental acquired Tenneco in an attempt to acquire Kern County Land Company. While Occidental sold its interest in Island Creek Coal Co. to resolve regulatory concerns and then turned

around and acquired Island Creek Coal Co. in a transaction not at issue in the Occidental decision. Both of these sales were quite different from our issues here. Tenneco was never a target of Occidental. The Island Creek Coal Co. sale was done in furtherance of an objective not at issue in the case and was merely just a sale and served mostly an investment purpose. [Redacted]'s sales in this case are more akin to the three sales in Occidental deemed to be business income and less like the two sales deemed to be nonbusiness income. Again, as pointed out in the American Smelting case, the [Redacted] transactions were not "incidental benefits from investments in general, such as enhanced credit standing and additional revenue . . ." but were transactions "incidental to and connected with the taxpayer's business operation." *Id.* at 933, 592 P.2d at 48.

The Tenneco transaction in Occidental has more significance. [Redacted], [Redacted]'s 'partner' in [Redacted], wanted to buy another company called [Redacted] and had to divest itself of interests in [Redacted] to satisfy [Redacted] laws. The [Redacted] issue was one that [Redacted]'s partner brought on itself because of its desire to purchase [Redacted] and one that it appears [Redacted] also voluntarily cooperated in to further its business interests. Unlike the Tenneco sale where Occidental sold due to a failed takeover bid, [Redacted] did not sell its interests in [Redacted] due to a failed enterprise. To the contrary, [Redacted] sold [Redacted] as a willing player in [Redacted]'s purchase of [Redacted].

The Island Coal Creek Co. transaction also has additional significance. Occidental owned Island Coal Creek Co. for only part of a year. The acquisition and disposition of [Redacted]'s interests in [Redacted]did not occur quickly which indicates it is more business income than nonbusiness income. This similar time period was also a basis for our decision to treat the income from the sale of a business as business income in Docket Nos. 16707 & 16708. [Redacted] announced its purchase of [Redacted] in [Redacted]. [Redacted] purchased the company in

[Redacted], bought even more of [Redacted] in [Redacted], sold it in [Redacted], and retained alliances and services from the transactions. The effects from the acquisition, management, and disposition of [Redacted] interests occurred over at least two years and even until today with integrated services still being offered.

Conclusion of [Redacted] Analysis

[Redacted]'s transactions involving [Redacted] were "Not merely to increase the investor's profitability, but instead, was (were) to transform the nature of the investor's business." Hercules v. Comptroller of the Treasury, 699 A.2d 461 (Md.App. 1997) ("were" added for grammatical purposes only). The purchase and subsequent sale of [Redacted] interests served much more than an investment function, and was not merely an asset to be bought and subsequently sold in a passive manner. [Redacted] utilized [Redacted] to further its integral and necessary business operations. The sale allowed [Redacted] to expand in the [Redacted] market, created opportunities and alliances for [Redacted]'s future growth, and integrated some of [Redacted]'s services into its own. Science v. Applications International Corporation v. Comptroller of the Treasury, Maryland Tax Court, No. 04-IN-OO-0632, May 11, 2006.

Moreover, when determining the question of business and non-business income in Idaho, the wording in I.C. § 63-3027(a) (1) of "acquisition, management, or disposition" varies slightly from the UDITPA wording of "acquisition, management, and disposition") (emphasis added). Under Idaho statutory language acquisition with the intent to integrate requires a finding of business income. Idaho's statute is written in the disjunctive and does not require that the property be acquired and managed and disposed of as part of the business. Nevertheless, in this case all of the elements of the statute are satisfied and considering all of the facts the integrity of the Allied-Signal analysis is met and it is business income. Idaho's transactional and functional tests are satisfied.

Petitioner fails to overcome its burden by statutory presumption that the gains from the sale of [Redacted] interests are deemed to be business income.

[Redacted]The main issue in this case has been the determination of [Redacted]. However, on [Redacted], [Redacted] also sold a [Redacted] percent interest in a company called [Redacted]. The gain on this intangible sale was determined to be business income by the Audit Division. The Audit Divisions's determination of [Redacted] is more difficult to analyze based on the limited amount of information in the record. However, from the record the [Redacted] transaction appears to be similar to the [Redacted] transaction. [Redacted], like [Redacted] was in the same line of business as [Redacted]. [Redacted] is a [Redacted]. The audit staff found notes during the audit indicating that [Redacted] was an integral part of [Redacted] business and would further its interests in the [Redacted] industry and [Redacted] industry. [Redacted] and [Redacted] would benefit each other by the complementary use of each other's services to advance each other's interests. Again, Petitioner failed to overcome the statutory presumption that the gains from the sale of stock in [Redacted] are deemed to be business income.

[Redacted]During the informal hearing process [Redacted] representatives indicated that although they did not agree to the determination of the treatment of [Redacted] in the audit they were no longer pursuing that claim in the appeal process. The adjustments made by the Audit Division are not disturbed by the Commission.

Rent Denominator

The Commission agrees with [Redacted] that [Redacted] was correct in regards to this issue and the tax liability is modified accordingly.

CONCLUSION

The Commission finds the gains from the sales of the [Redacted] stocks and stock options constitute business income under the statutory definition of business income and the inclusion of those gains in the combined group's pre-apportionment tax base is consistent with the Due Process and Commerce Clause holdings set forth in Allied Signal and the other U.S. Supreme Court decisions discussed above. As a result, the Division's deficiency determination regarding the gains is upheld, but other modifications as indicated above will be made to the deficiency.

WHEREFORE, the Notice of Deficiency Determination dated December 15, 2005, is hereby MODIFIED and MADE FINAL as adjusted herein.

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
12/31/2001	$105,680	$-0-	$29,043	$134,723
12/31/2002	11,034	-0-	2,230	13,264
12/31/2003	-0-	-0-	-0-	-0-
			TOTAL DUE	$147,987

Interest is calculated through October 10, 2006.

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. As set forth in the enclosed explanation you must deposit with the Tax Commission 20 percent of the total amount due in order to appeal this decision. The twenty percent deposit will be held as security for the payment of taxes until the appeal is finally resolved.

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.

Receipt No.