BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 20983
[Redacted],	)	
	)	DECISION
Petitioner.	)	
	)	
	)	

INTRODUCTION

On December 27, 2007, 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 tax due in the amount of $338,941 for the taxable years 2002 through 2005. On February 28, 2008, [Redacted] filed a timely appeal and petition for redetermination. An informal conference was held January 20, 2009, at [Redacted] request. Thereafter, the taxpayer notified the Commission that it did not wish to submit additional information in the matter. The Commission reviewed the file and information obtained at the informal conference and now issues a final decision.

FACTS

[Redacted] acquired [Redacted]. [Redacted] incorporated a parent company known as [Redacted] around 1982. In 1994, [Redacted] was adopted as the company name. [Redacted] sold its [Redacted] to concentrate on [Redacted] by 1998. As of the fiscal year 1999, [Redacted] provided products and services to [Redacted] providers and manufacturers. [Redacted] also helps [Redacted] providers and manufacturers improve their efficiency and quality.

The following recitation of pertinent facts is derived mostly from [Redacted] February 28, 2008, letter requesting a redetermination of the Notice of Deficiency, discussions

[Redacted] had with audit staff, and information obtained from [Redacted] at the informal hearing.

[Redacted] is [Redacted] company regulated and licensed by the [Redacted]. [Redacted] provides [Redacted] coverage for the taxpayer with respect to [Redacted]. The [Redacted].

[Redacted].

[Redacted]. The limited partnership is 1 percent and 99 percent owned by [Redacted] respectively. Both of [Redacted] partners are included in the taxpayer's combined unitary group for Idaho corporate income tax purposes. Because [Redacted] partners were included in the taxpayer's combined unitary filing group for the tax periods ending June 30, 2003, through June 30, 2005, the taxpayer also included [Redacted] sales in its group's apportionment formula.

FIRST ISSUE

UNITARY

The first issue is whether [Redacted] should be combined with [Redacted] pursuant to Idaho Code § 63-3027(t).

A. INTRODUCTION TO THE UNITARY ANALYSIS.

In 1965, Idaho adopted, with slight modification, the Uniform Division of Income for Tax Purposes Act (UDITPA). *See* 1965 Sess. Laws, Ch. 254, p. 639 (amending Idaho Code § 63-3027 to provide for allocation and apportionment of corporate income per UDITPA). UDITPA sets forth the process for determining the portion of a multistate corporation's total income that is to be attributed to Idaho for income tax purposes. UDITPA divides a corporation's income into two classes: (1) business income, and (2) nonbusiness income. Business income is apportioned according to a three-factor formula, while nonbusiness income is allocated to a specific state according to set allocation rules. *See* Idaho Code § 63-3027(i)

(providing for the apportionment of business income via a three-factor formula) and Idaho Code § 63-3027(d) – (h) (providing allocation rules relating to certain types of nonbusiness income). The business income apportioned to Idaho, and the nonbusiness income allocated to Idaho, are subject to Idaho's corporate income tax.

Idaho has modified the basic UDITPA income attribution rules to require "combined reporting" of the income of certain affiliated corporations. Idaho Code § 63-3027(t). As explained by the Idaho Supreme Court in Albertson's, Inc. v. State, Dept. of Rev., 106 Idaho 810, 683 P.2d 846 (1984), combined reporting is a refinement of the UDITPA apportionment principle.

> The combined reporting provision of subsection (s) [now I.C. § 63-3027(t)] is a further refinement of the basic apportionment principle. Its purpose is to permit application of the UDITPA formula to a single business enterprise which is conducted by means of separately incorporated entities. In an economic sense such a business is no different than a similar business composed of a single corporation with several separate divisions. For tax reporting purposes such businesses should be treated the same.

Id. at 814-815, 683 P.2d at 850-851 (citations omitted) (*quoting* American Smelting & Ref'g Co. v. Idaho St. Tax Comm., 99 Idaho 924, 934-935, 592 P.2d 39, 49-50 (1979), *rev'd on other grounds*, ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307, 102 S.Ct. 3103 (1982)).

As currently codified, Idaho Code § 63-3027(t) provides in part that "[f]or purposes of this section . . . the income of two (2) or more corporations, wherever incorporated, the voting stock of which is more than fifty percent (50%) owned directly or indirectly by a common owner or owners, when necessary to accurately reflect income, shall be allocated or apportioned as if the group of corporations were a single corporation, in which event . . . [t]he Idaho taxable income of any corporation subject to taxation in this state shall be determined by use of a combined report which includes the income . . . of all corporations which are members of a

unitary business, allocated and apportioned using apportionment factors for all corporations included in the combined report and methods set out in this section." With certain exceptions not relevant here, the Idaho Income Tax Administrative Rules provide that any corporation that is a member of a unitary business and is transacting business within this state must compute its Idaho corporate income tax liability under the combined reporting method. IDAPA 35.01.01.600.02 (2004). The issue raised in this administrative protest is whether [Redacted] is a member of the unitary business conducted by [Redacted] and its affiliated subsidiaries.

B. OVERVIEW OF THE UNITARY BUSINESS CONCEPT**.**

Before moving to the merits of the taxpayer's argument, it may be useful to provide an overview of the unitary business concept. Generally speaking, a unitary business is a single economic enterprise that is made up of a group of commonly owned or controlled business entities. Prior to the advent of the unitary business concept in the early 1900s, most states generally determined the amount of income earned within their borders by applying separate accounting principles to each separate business entity. However, by the early part of the twentieth century, with the growing size and complexity of multistate businesses, the separate accounting method of measuring taxable income proved to be unsatisfactory. Because large corporations typically do business through networks of interlocking subsidiaries and divisions, enabling the enterprise to shift income, expenses, property, payroll, and sales among its various subsidiaries and divisions at will, the states sought a way to more accurately account for and tax the in-state income of these multistate (and often multi-entity) business enterprises. This led to the development of the unitary business concept. The unitary business concept -- as refined through the requirement of "combined reporting" -- treats a group of commonly owned

businesses as a single unit for purposes of allocating and apportioning the income of that enterprise among the various states where it conducts its business operations. *See generally,* Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 164 – 169, 103 S.Ct. 2933, 2940 – 2942 (1983) (discussing the unitary business principle in light of the California combined reporting requirement).

Whether two or more business entities constitute a unitary business is a factual determination that has spawned considerable litigation over the years. No bright-line test can be employed in determining whether two or more business entities are engaged in a unitary business. "Unity can be established under any one of the judicially acceptable tests (Butler Bros., Edison California Stores, Container, etc.), and cannot be denied merely because another of those tests does not simultaneously apply." California Franchise Tax Board Notice 92-4, 1992 WL 207038. And even within these different definitions of what constitutes a unitary business, there is an unmistakable level of subjectivity. While the decision maker will be presented with various facts that either weigh for or against a finding of unity, in many cases, reasonable people can disagree whether the weight of the evidence tips the scales in one direction or the other. Allied-Signal, Inc. v. Director, Division of Taxes, 504 U.S. 768, 785, 112 S.Ct. 2251, 2262 (1992) ("If lower courts have reached divergent results in applying the unitary business principle to different factual circumstances, that is because . . . any number of variations on the unitary business theme are logically consistent with the underlying principles motivating the approach, . . . and also because the constitutional test is quite fact sensitive."). (Citations and internal quotations omitted.) But for all its problems and shortcomings, the unitary business principle is the backbone of modern state corporate income tax law. Formula apportionment, such as is required by Idaho Code § 63-3027, would not be possible absent the advent and

development of the unitary business principle. *See* Mobil Oil Corp. v. Com'r of Taxes of Vermont, 445 U.S. 425, 439, 100 S.Ct. 1223, 1232 (1980) ("the linchpin of apportionability in the field of state income taxation is the unitary-business principle.")

C. UNITARY PRESUMPTION**.**

For constitutional purposes, the U.S. Supreme Court has consistently held that the burden is on the taxpayer to show that there is no unitary relationship between a parent and its subsidiary and, as a result, the state -- in making a unitary finding -- is attempting to tax income derived from activities of a "discrete business enterprise" carried on outside its borders. *See, e.g.*, Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 223, 100 S.Ct. 2109, 2120 (1980) ("In order to exclude certain income from the apportionment formula, the company must prove that 'the income was earned in the course of activities unrelated to the sale of petroleum products in that State.'") (*Quoting* Mobil Oil Corp. v. Com'r of Taxes, 445 U.S. 425, 439, 100 S.Ct. 1223, 1232 (1980)). Thus, in the present administrative protest, the burden is on [Redacted] to show that it is not part of the [Redacted] unitary group. As discussed more fully below, we find that the company has not successfully met its burden, and the Commission, therefore, upholds the audit staff's determination that [Redacted] is part of the [Redacted] unitary group.

D. APPLICATION OF THE CONTRIBUTION – DEPENDENCY TEST.

[Redacted]. See Idaho Tax Commission Income Tax Rule 344. Idaho Code § 63-3027(t)(1) specifies that "all corporations which are members of a unitary business" are to be included in the combined group "when necessary to accurately reflect income."

As explained above, in Edison California Stores, Inc. v. McColgan, 183 P.2d 16 (Cal. 1947), the California Supreme Court articulated what has since come to be known as the "contribution – dependency" test. As succinctly set forth by the California Supreme Court: "If 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, the operations are unitary; otherwise, if there is no such dependency, the business within the state may be considered to be separate." Id. at 21. The Idaho Supreme Court has cited with approval both the three unities test set out in Butler Brothers and the contribution – dependency test first articulated in Edison California Stores. *See* Albertson's Inc. v. State, Dept. of Rev., 106 Idaho 810, 815 - 816, 683 P.2d 846, 851 - 852 (1984).

For determining unity, the Edison "contribution – dependency" test is dispositive of the question. It is unnecessary to review any other unitary tests. Clearly, [Redacted].

E. [Redacted].

[Redacted].

[Redacted] cite to [Redacted] in support of the proposition that it would be contrary to the due process clause of the U.S. Constitution for Idaho to tax [Redacted] insurance transactions with [Redacted] is not applicable. [Redacted] would only be applicable if Idaho was trying to assert a premiums tax or income tax on [Redacted]. Idaho is not asserting either. [Redacted] does not pay an Idaho premiums tax. Also, including a corporation in the combined report (including its numbers in the denominator) does not result in the taxation of that particular corporation. Container Corp., 463 U.S. 159, 164 – 169, 103 S.Ct. 2933, 2940 – 2942.

F. DOCKET No. 18612

Next, [Redacted] argues that the Commission's prior decision in Docket No. 18612 should not control the analysis in this case because Docket No.18612 was appealed to an Idaho district court and was rendered after the audit periods in question. Docket No. 18612 is not relevant to the analysis in this case. This case is being determined as set out above, and the Commission's analysis above sufficiently resolves the unitary questions.

SECOND ISSUE

SALES IN THE DENOMINATOR ([Redacted])

[Redacted] supports the [Redacted] purchasing activity for the taxpayer's [Redacted]distribution business segment. The limited partnership is owned by two partners, [Redacted]. These two partners are included in the taxpayer's combined unitary group for Idaho corporate income tax purposes. Because [Redacted] partners were included in the taxpayer's combined unitary filing group for the tax periods ending June 30, 2003 through June 30, 2005, the taxpayer also included [Redacted] sales in its group's apportionment formula. The additional inclusion of [Redacted] sales in its sales denominator results in those sales being included twice in the unitary group's sales denominator. However, intercompany transactions are not double counted in the sales denominator. See Idaho Tax Commission Rules 115.03.iv., 450.02, 600.04, and 620.04.b. The audit staff's exclusion of [Redacted] sales is upheld.

THIRD ISSUE

PENALTIES

The Audit Staff included a 10 percent substantial underpayment penalty for both the [Redacted] insurance [Redacted] issue. As [Redacted] points out, pursuant to Idaho Code § 3046(d)(7), the Commission may waive all or part of these penalties if the taxpayer shows reasonable cause for the underpayment and that the taxpayer acted in good faith. The Commission, based upon the analysis above, upholds the audit staff's penalties in this matter.

CONCLUSION

It is well settled in Idaho that a Notice of Deficiency Determination issued by the Idaho State Tax Commission is presumed to be correct. Albertson's Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814 (1984); Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2 (Ct. App. 1986). The burden is on the taxpayer to show that the tax deficiency is erroneous. Id.

Since the taxpayer has failed to meet this burden, the Commission finds that the amount shown due on the Notice of Deficiency Determination is true and correct.

The Commission upholds the determination that [Redacted] should be included in [Redacted] group. The Commission also upholds the determination that the sales factor of [Redacted] should be removed.

The Bureau also added interest, which will continue to accrue pending payment of the tax liability pursuant to Idaho Code §63-3045(6), and penalty to the taxpayer's tax deficiency. The Commission finds those additions appropriate as provided for in Idaho Code §§ 63-3045 and 63-3046.

WHEREFORE, the Notice of Deficiency Determination dated December 27, 2007, is hereby APPROVED, AFFIRMED, and MADE FINAL.

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
6/30/2002	$ 0	$ 0	$ 0	$ 0
6/30/2003	84,996	8,495	31,357	124,848
6/30/2004	95,430	9,539	29,677	134,646
6/30/2005	77,348	7,731	19,390	104,469
		TOTAL AMOUNT DUE		$363,963

Interest is calculated through October 7, 2009.

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.

DATED this _____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, 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]