BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NOS. 18315 and
[Redacted],	)	18316
	)	
Petitioner.	)	DECISION
	)	
	)	

Procedural Background

On July 15, 2004, the staff of the Income Tax Audit Bureau (Audit Bureau) of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination to [Redacted] (Petitioner), proposing a total refund of taxes and interest in the amount of $[Redacted]. The proposed refund concerns the periods ending December 31, 1995, December 31, 1996, December 31, 1997, [Redacted], December 31, 1998, December 31, 1999, and December 31, 2000. The matter was originally docketed as Docket No. 18315.

On September 16, 2004, the Petitioner filed a timely protest and petition for redetermination. The matter was retained at the audit level for resolution and to conduct an audit of a company acquired by the Petitioner and a successor company. The subsequent audit was docketed as Docket No. 18316. As a result of the audit, taxable year ending December 31, 1996, was adjusted for a net operating loss carryback regarding the predecessor company. Because taxable year 1996 is common to both dockets, the dockets were combined.

While the protest was pending, the Petitioner also filed amended returns reporting federal adjustments to the income and deductions the Petitioner filed with the Internal Revenue Service.

These federal adjustments resulted in adjustments to the Petitioner's Idaho income taxes. Incorporating the federal adjustments effectively removed taxable years ending December 31, 1995, and December 31, 1996, from further consideration. Those taxable years, therefore, will not be discussed further in this decision.

Additionally, as a result of the federal adjustments and other on-going audit adjustments, the Audit Bureau issued a revised Notice of Deficiency Determination on December 12, 2008. The Audit Bureau proposed a deficiency of tax and interest in the amount of $[Redacted]. The Petitioner filed a Petition for Redetermination of the modified deficiency on February 10, 2009.

The Petitioner and the Audit Bureau continued to communicate. Under the cover of letters dated February 10, 2009, March 23, 2009, and April 21, 2009, the Petitioner supplied additional information to the Audit Bureau. As a result of this additional information, the Audit Bureau again modified its audit report. On May 7, 2009, the Audit Bureau issued a modified audit report and Notice of Deficiency Determination which contained the following modifications:

- Additional federal adjustments with the resulting Idaho adjustments
- Allowance of the Internal Revenue Code sections 265 and 291 interest and expense offset
- Allowance of interest received from Idaho municipal securities
- Recognition of [Redacted] as an excluded insurance company for the taxable year ending December 31, 2000
- Credit for the tax previously paid regarding taxable year ending December 31, 1997.

The result of the modified report was to reduce the proposed deficiency to the amount of $[Redacted], including both tax and interest.

Because some issues were still unresolved, the protest was referred to a Commissioner for further consideration. The Petitioner had requested a conference with a Commissioner, but

asked that the matter be held in abeyance. At the Petitioner's request, this matter was held in abeyance pending the disposition of a related matter in the United States Supreme Court and other matters before the Tax Commission. The related matters were resolved, and an informal conference was conducted on April 8, 2010.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision AFFIRMING the modified Notice of Deficiency Determination issued on May 7, 2009.

Issues

The Petitioner raised four primary issues in the Petition for Redetermination filed with the Tax Commission. The Petitioner states:

1. The Audit Bureau was precluded from including certain insurance affiliates in the combined group under the time limitations set forth in Idaho Code § 63-3068.

2. Including the Petitioner's insurance affiliates in the combined group that reports to Idaho is contrary to Idaho Code § 41-405 and facially discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution.

3. Dividends received from the Federal Reserve Bank and from the Federal Home Loan Bank are exempt from state taxation by federal law.

4. Taxing income from non-Idaho state and local obligation while exempting income from Idaho state and local obligation discriminates against the non-Idaho obligation in violation of the Commerce Clause of the United States Constitution.

Background Facts

The Petitioner is a unitary banking business that operates in the state of Idaho and many other states. The bank accepts checking, savings, and other time-deposits. The Petitioner uses

these funds to make consumer, real estate and commercial loans, and investing in securities and other interest bearing assets. The loans and investment activities are directed to Idaho customers as well as customers in other states. Many of the members of this Petitioner's banking business are members of the Federal Deposit Insurance Corporation and of the Federal Reserve System.

Law and Analysis

1. The Statute of Limitation for Issuing a Deficiency

Between the time of the original deficiency in this matter and the conference, the Petitioner and Audit Bureau continued the audit and continued to make adjustments to the Petitioner's tax liability. One of the adjustments made by the Audit Bureau was the inclusion of certain of the Petitioner's insurance affiliates in the combined group. The Petitioner now argues that the adjustment was barred under the time limits set forth in Idaho Code § 63-3068.

This time restriction is often referred to as "the statute of limitations." Idaho Code § 63-3068 limits the time in which the Commission may issue a Notice of Deficiency Determination. The statute provides in part:

> **63-3068. Period of limitations for issuing a notice of deficiency and collection of tax. --** (a) Except as otherwise provided in this section, a notice of deficiency, as provided in section 63-3045, Idaho Code, for the tax imposed in this chapter shall be issued within three (3) years from either the due date of the return, without regard to extensions, or from the date the return was filed, whichever is later.

Under this statute, both the taxpayer and the Tax Commission generally must act within three years of the date the return was filed or due, whichever is later, without regard to extensions.

The statute of limitations can be extended or waived by written consent of the parties. The written consent is referred to as a Waiver and Extension of Limitations. In this case, the Audit Bureau obtained a Waiver and Extension of Limitations before it issued its original

deficiency on July 15, 2004. The extension applied to taxable years in question except taxable year ending December 31, 1997.

As a consequence, the Audit Bureau adjusted taxable year ending December 31, 1997 for the federal adjustments and net operating losses reported by the Petitioner. The Audit Bureau did not make other adjustments to that taxable year.

However, for other taxable years which were "open" years at the time the original deficiency was issued, the Audit Bureau continued to make adjustments as additional information became available. The taxable year is called an "open" year because it is still subject to an assessment of a deficiency and a taxpayer also is within the timeframe for claiming a reduction or refund of tax. Idaho Code § 63-3072 regarding refund claims provides a similar three-year limitation for claiming offset or refunds.

An exception to the general three-year limitation exists for both deficiencies and refunds in the Idaho Code. Regarding deficiencies, Idaho Code § 63-3038 specifically provides "the period of limitations as provided in this section shall be suspended" once a Notice of Deficiency Determination is issued. *See* Idaho Code § 63-3068(m). After a Notice of Deficiency Determination is issued, both the taxpayer and the Commission may take appropriate steps to ensure the deficiency is neither understated nor overstated. Since the Audit Bureau issued the Notices of Deficiency Determination before the expiration of the respective three-year limitation for each taxable year except taxable year 1997, the limitations were tolled.

The underlying policy is obvious. The goal to the audit and appeal process is to arrive at the correct tax liability for the Petitioner. Indeed, as discussed above, the Petitioner received numerous adjustments in its favor as a result of the on-going exchange of information. It seems somewhat disingenuous that the Petitioner now complains about an adjustment which is

perceived as unfavorable. As discussed next, the Audit Bureau correctly included insurance affiliates in the combined group that reports to Idaho.

2. Including Insurance Affiliates in the Combined Group

Statutory Analysis

Idaho Code § 41-405(1) provides that payment of the Idaho premium tax "shall be in lieu of all other taxes upon . . . income, franchise or other taxes measured by income . . . ." Thus, insurance companies that are subject to, and actually pay, the Idaho premium tax are exempt from the Idaho income tax. However, that does not necessarily mean that an exempt insurance company cannot be included in a combined group calculation relating to a subsidiary corporation that has an Idaho income tax filing requirement. Including an exempt subsidiary in the combined group calculation is not equivalent to taxing the income of that exempt company. *C.f.* Barclays Bank PLC v. Franchise Tax Board, 512 U.S. 298, 311 n. 10, 114 S.Ct. 2268, 2277 n. 10 (1994) ("Formulary apportionment of the income of a multijurisdictional (but unitary) business enterprise, if fairly done, taxes only the income generated within a State.") (citation and internal quotations omitted). In this respect, an exempt insurance subsidiary is no different than a subsidiary exempt from Idaho income taxation by Public Law 86-272. So long as the payroll, property, and sales of the exempt subsidiary are included in the combined group denominators, there is no inherent or theoretical reason why the income of the exempt subsidiary cannot be included in the combined group total apportionable income that is then apportioned to Idaho on the return filed by an Idaho-nexus taxpayer. *See* State v. Penn Independent Corporation, 15 Or. Tax 68 (1999).

It is permissible to include an exempt insurance subsidiary in the combined group calculation relating to an Idaho-nexus taxpayer. In fact, that is the current practice of the Tax

Commission. However, for the taxable years in question, the Commission had a policy of excluding exempt insurance companies from the combined group. The policy was set forth in Income Tax Administrative Rule 600.06, IDAPA 35.01.01.600.06 (2000). The rule at that time read: "[p]ursuant to Section 41-405, Idaho Code, an insurance company subject to the premium tax may not be included in a combined group." The rationale for this policy seemed to be based in part on the fact that California excluded exempt insurance subsidiaries from the California combined group report.[1]

[Redacted] argues that it is "subject to the premium tax" as that term is used in Rule 600.06. Although the Petitioner does not actually pay a premium tax to the Idaho Department of Insurance for the activity it conducts, the Petitioner is contractually obligated to pay or reimburse the premiums tax which other insurance companies must pay. In effect, the Petitioner asks the Tax Commission to construe the statutory exemption and accompanying rule broadly.

The Tax Commission finds that such a broad interpretation is contrary to the rules of statutory construction. Tax exemptions are never presumed or extended by construction of a statute. Bistline v. Bassett, 47 Idaho 66, 272 Pac. 696 (1929); Sunset Memorial Gardens, Inc. v. Idaho State Tax Commission, 80 Idaho 206, 327 P.2d 766 (1958); Ada County Assessor v. Roman Catholic Diocese of Boise, 123 Idaho 425, 849 P.2d 98 (1993). The terms of the

[1] According to the California Franchise Tax Board, a unitary insurance subsidiary may not be included in the combined report of a unitary business because an insurance company is not a "taxpayer" as defined by California's tax statutes. *See* FTB Legal Ruling 385 (3/28/75). Under California's combined reporting statute, only "taxpayers" are to be included in the combined report; and since insurance companies do not meet the statutory definition of a "taxpayer," they cannot be included. *Id.* However, the rationale and analysis followed in California for excluding insurance companies from the combined report does not apply under Idaho law. Idaho Code § 63-3027(t) [authorizing combined reporting] does not limit the makeup of the combined group only to "taxpayers." Rather, 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."

statutory exemption must be so specific and certain as to leave no room for doubt. Appeal of Evangelical Lutheran Good Samaritan Society, 119 Idaho 126, 804 P.2d 299 (1990).

Because tax exemptions are a matter of legislative grace rather than a guaranteed right, the exemption must be strictly and narrowly construed against the taxpayer. Owyhee Motorcycle Club, Inc. v. Ada County, 123 Idaho 962, 855 P.2d 47 (1993). Tax exemption statutes must be given their ordinary meaning and will not be sustained unless within the spirit as well as letter of the law. Church of Latter-Day Saints v. Ada County, 123 Idaho 410, 849 P.2d 83 (1993). Where more than one interpretation of statutory term or phrase is possible, courts must choose the narrowest possible reasonable construction of the tax exemption statute. Church of Latter-Day Saints, 123 Idaho at 416-7, 849 P.2d at 89-90.

The Commission finds that inclusion of [Redacted] in the combined report filed by the Petitioner is not prohibited by Idaho Code § 41-405 or by Income Tax Administrative Rule 600.06. The statute and rule do not contemplate exempting someone for paying a tax on another's behalf or reimbursing another when they pay the tax. We now turn to the constitutional question raised in this protest.

Constitutional Analysis

[Redacted] argues that the Commission's policy of excluding insurance subsidiaries that pay the Idaho premium tax, but do not exclude insurance subsidiaries that do not pay the tax, is discriminatory and violates the Commerce Clause. The Petitioner asserts the policy violates the Commerce Clause because it discriminates against interstate commerce by providing a preference for companies whose affiliates pay Idaho premium tax.

The principal flaw with the Petitioner's Commerce Clause argument is that the inclusion of an exempt or non-nexus unitary subsidiary in the combined group calculation does not

necessarily result in a higher tax liability for the Idaho-nexus taxpayer. For example, if a unitary insurance subsidiary has a net operating loss, inclusion of that subsidiary in the combined group calculation would reduce the Idaho tax liability of the Idaho-nexus taxpayer. Likewise, if a unitary insurance subsidiary has significant payroll, property, or sales that are included in the combined group apportionment denominator, the Idaho tax liability of the Idaho-nexus taxpayer might be less if the insurance subsidiary is included in the combined group calculation. Thus, the inclusion of an insurance subsidiary does not necessarily result in a higher Idaho tax burden. This fact is amply supported by the arguments raised in AIA Services Corp. v. Idaho State Tax Com'n, 136 Idaho 184, 30 P.3d 962 (2001). In that case, the taxpayer (AIA Services) wanted to have its exempt insurance subsidiary included in the combined group report and argued to the Idaho Supreme Court that the Tax Commission's policy of excluding exempt insurance subsidiaries violated the Commerce Clause. While the Idaho Supreme Court did not address AIA Services' Commerce Clause argument due to the fact that the company failed to raise the issue below, the case does point out that the Tax Commission's policy does not necessarily favor those "companies whose affiliates pay Idaho premium tax." AIA Services wanted to have its exempt insurance subsidiary included in the Idaho combined group report because it would have resulted in a tax savings.

[Redacted] has not met its burden of establishing that the Idaho policy relating to exempt insurance subsidiaries discriminates against interstate commerce by granting preferential treatment to in-state activity. In addition, even if the policy was discriminatory, the remedy would be to invalidate Rule 600.06, not to expand that rule to cover "non-exempt" insurance subsidiaries. *See, e.g.*, K-Mart Corp. v. Idaho State Tax Com'n, 111 Idaho 719, 722, 727 P.2d 1147, 1150 (1986) ("Statutes control interpretive regulations. To the extent a regulation is

unconstitutional, it is inconsistent with the constitutional statute it purports to interpret and is, therefore, of no effect to the extent of such inconsistency.") The Tax Commission, therefore, rejects the Petitioner's Commerce Clause claims.

3. Taxing Dividends Received from the Federal Reserve Bank and the Federal Home Loan Bank

Dividends from the Federal Reserve Bank

The Federal Reserve System's booklet titled "The Federal Reserve System Purposes & Functions" describes the member bank structure as follows:

> [T]he nation's banks can be divided into three types according to which governmental body charters them and whether or not they are members of the Federal Reserve System. Those chartered by the federal government (through the Office of the Comptroller of the Currency in the Department of the Treasury) are national banks; by law, they are members of the Federal Reserve System. Banks chartered by the states are divided into those that are members of the Federal Reserve System (state member banks) and those that are not (state nonmember banks). State banks are not required to join the Federal Reserve System, but they may elect to become members if they meet the standards set by the Board of Governors.[2]
>
> * * *
>
> A bank that is a member of the Federal Reserve System must, under the Federal Reserve Act, subscribe to the capital stock of the Reserve Bank of its District. The total amount of a member bank's subscription is equal to 6 percent of its current capital stock and surplus. Of this amount, one-half is capital paid in and one-half is subject to call by the Board of Governors. These shares, unlike ordinary stock in private banks or corporations, do not carry voting power to control the policies of the Reserve Banks. Member institutions are entitled by statute to a cumulative dividend of 6 percent per year on the value of their paid-in stock. Holdings of Reserve Bank stock may not be transferred, nor may the shares be used as collateral for loans.[3]

[2] Chapter 1, Overview of the Federal Reserve System, page 13, Member Banks.
[3] Appendix A, Federal Reserve Bank Balance Sheet and Reserve Equation, page 117, Capital Accounts.

Member banks of the Federal Reserve System are entitled by statute to an annual dividend of 6 percent on paid capital[4]. In arriving at net business income subject to apportionment, the Petitioner subtracted dividends received on Federal Reserve Bank stock. The Tax Commission's Audit Bureau disallowed the Petitioner's deductions.

The Petitioner cited Idaho Code § 63-3022(g) as support for subtracting the Federal Reserve Bank dividends from Idaho taxable income, because Idaho Code § 63-3022(g), in part, allows a subtraction for any income exempt from Idaho taxation under the provision of any law of the United States. The Petitioner asserts the dividends are exempt from state taxation as a matter of federal law.

In 1913, Congress created the Federal Reserve System under the Federal Reserve Act of 1913. Section 7, undesignated paragraph 3, of the Federal Reserve Bank Act of 1913 (currently 12 U.S.C.A. § 531) provides the following:

> Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

The Petitioner argues that 12 U.S.C. § 531 and its legislative history continue to exempt Federal Reserve Bank dividends from state and local taxation.

This argument ignores that Section 4 of the Public Debt Act of 1941, as amended in 1942, removed <u>any exemption for dividends under federal tax acts.</u> In 1941**,** Congress passed the Public Debt Act of 1941, and Section 4 of this Act reads, in part, as follows:

> Sec. 4. (a) Interest upon, and gain from the sale or other disposition of, obligations issued on or after the effective date of this Act by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted;…

In 1942**,** realizing they had overlooked the tax exemption privilege enjoyed by shares and other

[4] 12 U.S.C. § 289

evidences of ownership issued by various agencies and instrumentalities of the United States, Congress corrected its oversight.

> Sec. 4. (a) Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidence of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective dated of the Public Debt Act of 1942 by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted; …

Section 6 of the Public Debt Act of 1942 amending Section 4 of the Public Debt Act of 1941.

In 1947**,** Congress further amended Section 4 of the Public Debt Act of 1941 to read, in part, as follows:

> Sec. 4. (a) Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective date of the Public Debt Act of 1942 by the United States or any agency or instrumentality thereof <u>shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment</u>, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto;…

(Emphasis added). In 1959, Congress codified Section 4 of the Public Debt Act of 1941 (including subsequent amendments) as 31 U.S.C. § 742a.

In 1982, numerous words were omitted as surplus while other words were replaced for clarity when 31 U.S.C. § 742a was revised and re-designated as 31 U.S.C. § 3124(b). 31 U.S.C. 3124 provides in part:

> Sec. 3124 Exemption from taxation
>
> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except -

(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and

(2) an estate or inheritance tax.

(b) The tax status of interest on obligations and dividends, earnings, or other income from evidences of ownership issued by the Government or an agency and the tax treatment of gain and loss from the disposition of those obligations and evidences of ownership is decided under the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.). . .:[5]

(Emphasis added). The Internal Revenue Code, in its definition of gross income, does not provide for an exemption for dividends received on Federal Reserve Bank stock.

The Idaho income tax is specifically tied to the federal determination of income. Idaho Code § 63-3002 states the legislative intent to follow the federal treatment. It states in part:

63-3002. Declaration of intent. It is the intent of the legislature by the adoption of this act, insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income, to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income,. . . and other pertinent provisions to gross income as defined therein, resulting in a final amount called "taxable income" in the Internal Revenue Code . . . . All of the foregoing is subject to modifications in Idaho law including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States.

(Emphasis added). Under Idaho income tax law, there is no specific modification that allows a taxpayer to subtract dividends received on Federal Reserve Bank stock.

By following the federal treatment, the plain language of 31 U.S.C. § 3124(b) provides that Idaho may impose a corporate franchise or income tax on the interest or other income received on the stock. The Petitioner argues that certain legislative history would suggest Congress only intended to remove the tax exemption for the federal income tax. However, the

[5] The wording of 31 U.S.C. § 3124 is substantially the same today as it was in 1982, the year in which 31 U.S.C. §§

Tax Commission is not persuaded that out-of-context references to legislative history should change a clear reading of the plain language of the statute. While the process for drafting is often uncertain, the Tax Commission finds the federal statutes that resulted from that process to be clear. The Public Debt Act removed the exemption for Federal Reserve Bank dividends previously immune from federal, state, and local taxation under the Federal Reserve Bank Act of 1913. Since the exemption was removed, the dividends became subject to Idaho taxation.

Accordingly, the Tax Commission finds no federal law or Idaho law prohibiting Idaho's taxation of dividends paid on Federal Reserve Bank stock. The audit adjustment on this issue is upheld.

Dividends from the Federal Home Loan Bank

The related issue raised by the Petitioner is whether dividends paid to the taxpayer on stock in the Federal Home Loan Bank (FHLB) are taxable by Idaho. The Petitioner received substantial dividends on FHLB stock during the audit period.

A lending institution's eligibility for membership in the FHLB is set forth in 12 U.S.C. § 1424. The capitalization of the FHLB is set forth in 12 U.S.C. § 1426. Subsection (g) thereof provides: "(g) DIVIDENDS. All stock of any Federal Home Loan Bank shall share in dividend distributions without preference."

Taxation of the FHLB is addressed in 12 U.S.C. § 1433, which reads as follows:

> Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any . . . State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, . . . by any State, county, municipality, or local taxing authority; except that in [sic] any

742 and 742a were revised and renumbered as 31 U.S.C. §§ 3124(a) and 3124(b), respectively.

> real property of the bank shall be subject to State . . . or local taxation to the same extent according to its value as other real property is taxed. ...

The language here, "all notes, debentures, bonds, and other such obligations" clearly refers only to debt instruments. Notes, debentures, and bonds are all debt instruments, and "such obligations" limits the "obligations" to similar instruments. Bell Fed. Sav. & Loan Assn. v. Wagner, 675 N.E.2d 135, 138 (Ill. App. 1996). This is confirmed by the exemption being limited to "principal and interest." The second sentence makes "the bank" (meaning the FHLB, not a member bank) and its assets and income exempt from state tax. Taxation of dividends paid by the FHLB would not be prohibited by that sentence, since it is the member bank that is being taxed on its income, not the FHLB. Thus, by the terms of this section, dividends on FHLB stock are not exempt from state taxation

Moreover, the Public Debt Act discussed above (31 U.S.C. § 3124) would further limit the Petitioner's argument. In terms of this statutory structure, the taxpayer's contention raises a series of questions. The first issue is whether FHLB stock is a "stock . . . of the United States Government." The Tax Commission does not need to answer this question definitively, because, even if the answer is yes, taxation of the dividends is not a tax on the stock. This is confirmed by 31 U.S.C. § 3124(b), which refers specifically to "dividends ... from evidences of ownership." When Congress meant to refer to dividends, it did so expressly. The absence of mention of dividends in 31 U.S.C. § 3124(a) must be regarded as intentional.

The next issue is whether the reference in 31 U.S.C. § 3124(a)to "interest" encompasses dividends. The answer is no, again because dividends and interest are separately referred to in subsection (b). "Interest" in subsection (a) does not include dividends.

The next issue is whether the FHLB stock is an "obligation" within the meaning of the second sentence of subsection (a). The answer must be no because stock and obligations are

separately referred to in the first sentence of subsection (a). *See also* Smith v. Davis, 323 U.S. 111, 116 (1944)(obligation must bear interest); American Bank & Trust Co. v. Dallas County, 463 U.S. 855, 859 n.1 (1983); Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 397 (1983) (statute restates constitutional principle of intergovernmental immunity); First Nat'l Bank v. Bartow County, 470 U.S. 583, 593 (1985).

The Tax Commission, therefore, concludes that taxation of the dividends on FHLB stock in the hands of the taxpayer does not violate 31 U.S.C. § 3124. The Oklahoma Supreme Court reached the same result in Sooner Fed. Sav. & Loan Assn. V. Oklahoma Tax Comm., 662 P.2d 1366 (1982).

4. Taxing Income from Non-Idaho Obligations

This is one of the issues for which this matter was held in abeyance. In the case of Kentucky v. Davis, 553 U.S. 328 (2008), taxpayers filed a class action seeking declaratory judgment that Commonwealth of Kentucky's income tax structure, exempting interest on bonds issued by Kentucky or its subdivisions from state income tax, but taxing interest income on bonds from other states and their subdivisions, violated dormant Commerce Clause. The Petitioner raises the same claim regarding Idaho's taxation of income from bond and other obligations as the taxpayers in Davis.

The Court found that Kentucky's taxation of non-Kentucky obligations while exempting Kentucky obligations, did not violate the Commerce Clause. The Court found that, in instances in which the state is market participant, such as in the bond and obligation market at issue here, the state action falls under the "market-participation" exception to the dormant Commerce Clause limit on state regulation. Applying the Court's ruling to the instant case, the Tax Commission upholds the deficiency as it relates to this issue.

WHEREFORE, the Notice of Deficiency Determination dated May 7, 2009, is hereby AFFIRMED, and is APPROVED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the Petitioner pay the following tax and interest:

Year	Refund Claimed	Refund Allowed	Tax	Interest	Total
[Redacted]	($[Redacted])	([Redacted])		($[Redacted])	($ [Redacted])
[Redacted]	([Redacted])		[Redacted]	[Redacted]	[Redacted]
[Redacted]	([Redacted])		[Redacted]	[Redacted]	[Redacted]
[Redacted]			0	0	0
[Redacted]			[Redacted]	[Redacted]	[Redacted]
			Less payment received:		([Redacted])
			TOTAL DUE		$ [Redacted]

Interest is calculated through October 1, 2010, and will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given. An explanation of the Petitioner's right to appeal this decision is enclosed. As set forth in the enclosed explanation, the Petitioner must deposit with the Tax Commission 20 percent (20%) of the total amount due in order to appeal this decision. The 20 percent deposit in this case is $[Redacted] and will be held as security for the payment of taxes until the appeal is resolved.

DATED this ____ day of _____ 2010.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____ 2010, 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]
Copies Mailed to:

[Redacted]

_____