

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 22696
[Redacted],)	
)	DECISION
Petitioners.)	
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On January 22, 1010, the Idaho State Tax Commission’s (Commission) Income Tax Audit Bureau (ITA) issued a Notice of Deficiency Determination to [Redacted] (petitioners) proposing additional income tax, penalty, and interest for the taxable years 2004, 2005, and 2006, in the total amount of \$1,112,434. On January 13, 2011, the ITA prepared a modified Notice of Deficiency Determination (NODD) reducing the total amount from \$1,112,434 to \$1,072,365. The modified NODD was forwarded to the petitioners’ representative in September 2011 and is incorporated into this decision.¹ The petitioners filed a timely protest and petition for redetermination (Petition).² The Idaho Code section 63-3045(2) hearing was held on March 24, 2011. The Commission, having reviewed the file, hereby issues its decision.

I. ISSUE OVERVIEW (IN GENERAL)

The petitioners protest the ITA’s adjustment to its Idaho apportionment percentage as well as ITA’s proposed assessment of interest and penalty. Idaho’s apportionment percentage is a formula made up of three factors: property, payroll, and sales. Each factor is a fraction where the numerator is the amount attributable to Idaho and the denominator is the total amount. When combined, the factors establish the fraction (apportionment percentage) of the unitary business's

¹ The modified NODD was prepared to account for the reduction in federal taxable income as reported on the petitioners’ 2006 amended Idaho and federal income tax returns received by the Commission on September 15, 2010. The only adjustment made by ITA to the 2006 amended federal taxable income, as filed by the petitioners, was to correct the capital loss brought forward to line 9 of federal Form 1120 from federal Form 4797. The modified NODD recalculates the 2006 amended federal taxable income using the loss reported on line 17 of Form 4797 – not line 11. The federal taxable income correction flows to the calculation of Idaho apportionable income on the modified NODD.

² The term “petitioners” includes [Redacted][Redacted].

total business income that is subject to Idaho taxation. Collectively, the property, payroll, and sales factors are intended to represent a taxpayer's business activity within Idaho. If the factors do not fairly represent the taxpayer's business activity within Idaho, the taxpayer may request or the Commission may require that an alternative allocation and apportionment formula be applied. The basic issue in this docket is the treatment of the proceeds from forward contract trading activity when calculating the Idaho sales factor. All of those sales take place outside of Idaho and affect only the denominator of the sales factor. Any increase in the denominator of the sales factor decreases the percentage of the petitioners' business income that is taxable in Idaho. That is, it reduces the petitioners' Idaho corporate income taxes.

II. SPECIFIC FINDINGS

The sales factor denominator issue is a complex subject involving a number of questions. For example: is the forward contract trading activity part of a "treasury function," is it a liquid asset, is it marketable, what is the "gross receipt" of the forward contract trades, and would the inclusion of the forward trading full "contract price" result in a formula that does not fairly represent the business activity within Idaho? The Commission renders the following findings:

1. The cash received from the offset or "book-out" of the energy forward trades represents the "sum of money and the fair market value of other property or services received" included as a "gross receipt" in the sales factor under Idaho's standard apportionment formula.³
2. Allowing "gross receipts" that would include the return of principal from the forward contract trading to be included in the Idaho apportionment factor would not fairly represent the extent of the petitioners' business activity within Idaho.
3. The petitioners are subject to interest on the additional tax liability.

³ Since the Commission's finding is that the actual cash received to settle the forward contract, not the full contract price, constitutes the gross receipt, the Commission does not rule on the other issues involving trading function, liquidity, and marketability.

4. The petitioners are not subject to penalties on the additional tax liability.

III. COMPANY STRUCTURE⁴

[Redacted]. During the years in question, [Redacted], the parent corporation, had four business segments; [Redacted], and Other (the entities shown in all white plus those shown with grey horizontal stripes).⁵

[Redacted]

Chart Redacted.

[Redacted]. [Redacted]. [Redacted]. [Redacted] is the parent company of all of the subsidiary companies in the [Redacted] business segments, including [Redacted].

[Redacted], Inc. ([Redacted]), [Redacted] ([Redacted]), and [Redacted] ([Redacted]) are the entities that makeup the petitioners' [Redacted] business segment.

[Redacted] began operations in 1997 and is an [Redacted] marketing, trading, and [Redacted] business. [Redacted] is involved in [Redacted], including derivative commodity instruments, and its earnings are derived from the following principal activities:

[Redacted] trades electricity and natural gas, along with various derivative commodity instruments including forwards, futures, options, swaps, and other contractual arrangements. The vast majority of [Redacted] trades during the audit period were from forward contracts. A forward contract is a contract between a buyer and seller whereby the buyer is obligated to take delivery of a fixed amount of a commodity at a predetermined price on a specified future date. Payment in full is due at the time of delivery or following delivery. [Redacted] forward contracts generally are not traded on any domestic exchanges or boards of trade.

⁴ A substantial portion of the information pertaining to the operations and structure of the petitioners business was obtained from the petitioners' Petition.

⁵ The flowchart does not reflect all of the various owned entities including certain partnerships and single owned Limited Liability Companies.

In a typical [Redacted] forward contract transaction, [Redacted] enters into a master wholesale [Redacted] contract with a counter party. Counter parties to [Redacted] contracts include [Redacted]. Once both parties approve the master wholesale [Redacted], the [Redacted] employed by each party then engage in the trading [Redacted]. In accordance with [Redacted] trading strategy, [Redacted] traders are authorized to enter into long positions (buyer) and short positions (seller), often simultaneously, with the counter party. [Redacted] entered into the forward contracts to speculate in future energy price movements.

[Redacted] purchases (and takes title to) [Redacted] and resells (conveys title to) the purchased [Redacted] but does not own or operate any [Redacted] facilities. [Redacted] is a seller for resale of the traded [Redacted] for physical delivery as required under the contract. [Redacted] either receives or pays money to settle all of its contracts. Both the [Redacted] purchase and the subsequent [Redacted] re-sale are settled with cash. The [Redacted] purchases and associated re-sales are not made to end-user customers.

According to the ITA, [Redacted] provided [Redacted] services to end-user customers [Redacted] while [Redacted] engaged in serving as the [Redacted] agent [Redacted].

The ITA points out that, for financial reporting purposes, [Redacted] and [Redacted] reported gross income derived from contracts that are not derivatives and from the transactions of derivative commodity instruments not held for trading; while the derivative commodity instrument trading transactions were reported at net.

IV. IDAHO INCOME TAX FILINGS

For federal income tax purposes, the petitioners are included in a consolidated federal corporate income tax return. For Idaho income tax purposes, the petitioners are part of an affiliated group that engaged in a unitary business which transacts business within and without

Idaho. The petitioners filed as part of an Idaho worldwide combined report for taxable year 2004 through 2006.⁶ However, those entities shown in the previous flowchart with a grey horizontal line were not part of the unitary group. The combined group filed an Idaho group return for each year.⁷

Included within the combined group were four corporations that were required to file an Idaho corporate income tax return: [Redacted]. [Redacted] contained the regulated utility business part of which was transacting business within Idaho. [Redacted] has Idaho property, payroll, and sales due to an ownership interest in an LLC that was transacting business in Idaho. [Redacted] has Idaho property and sales due to an ownership interest in a limited partnership that was transacting business in Idaho. And finally, [Redacted] does not have any Idaho property, sales, or payroll but was subject to the Idaho minimum tax.

As previously mentioned, for multistate or multinational corporations transacting business within and without Idaho, a standard apportionment formula is used to determine the amount of business income subject to Idaho income tax.

The Idaho standard apportionment formula is comprised of three factors; property, payroll, and sales. The sales factor component of the formula is comprised of an Idaho sales numerator divided by total everywhere sales. In most cases, the sales factor is doubled, except in cases involving certain utility entities, the sales factor is not doubled.

The ITA audited the petitioners' Idaho corporate income tax returns and made several

⁶ A "combined report" refers to the computational filing method to be used by a unitary business which is conducted by a group of corporations. Idaho Income Tax Administrative Rule 325.05 and 06. (IDAPA 35.01.01.325.05 and 06.) Use of the combined report does not disregard the separate corporate identities of the members of the unitary group. The combined report is simply the computation, by the formula apportionment method, of the unitary business income reportable to Idaho by the separate corporate members of the unitary group. Idaho Income Tax Administrative Rule 365.01 (IDAPA 35.01.01.365.01).

⁷ Under Idaho law, a "combined group" is a group of corporations that compromise a unitary business and are includable in a combined report. In lieu of each corporation within a combined group that is required to file its own Idaho corporate income tax return, the combined group may instead file one Idaho corporate income tax return known as a "group return." Idaho Income Tax Administrative Rule 325.08 (IDAPA 35.01.01.325.08).

audit adjustments. The various audit adjustments impacted the Idaho apportionment factor as follows:

The only disputed audit adjustments to the petitioners' apportionment factor calculation were the removal of certain gross receipts from the petitioners' sales denominator. The ITA removed from the sales denominator the gross receipts as originally reported [Redacted] and replaced it with the operating revenue as reported for the [Redacted] business segment in the petitioners' 10-K filed [Redacted] for the years at-issue. The ITA used the 10-K operating income amounts since the operating income included (1) [Redacted] "gross revenue" from contracts that are not derivatives and derivative commodity instruments not held for trading, (2) [Redacted] "gross revenue" derived [Redacted] which are not held for trading, and (3) [Redacted] "net margin" on derivative commodity instruments held for trading.⁸

Numerically, the ITA made the following adjustments to the petitioners' everywhere sales factor figures as follows:⁹

Table Redacted.

The ITA, in its modified NODD explanation section on pages 12 and 13, explains that it removed the gross proceeds from the sales denominator because:

[Redacted]

In addition to citing Idaho Income Tax Administrative Rule 525.01, the ITA points to Idaho Income Tax Administrative Rule 525.03, Idaho Income Tax Administrative Rule 570.03, the Commission's decision in Docket No. 12715, and two non-Idaho court cases as additional authority for its position.¹⁰

⁸ The modified NODD explanation page 4.

⁹ The modified NODD schedule 1850.

¹⁰ The modified NODD explanation pages 4 through 5 and 12 through 13.

Idaho Income Tax Administrative Rule 525.01 states “Sales means all gross receipts of a taxpayer not allocated as nonbusiness income. The sales factor for each trade or business of the taxpayer includes all gross receipts derived by the taxpayer from transactions and activity in the regular course of that trade or business.”¹¹

Income Tax Administrative Rule 525.03 states “In some cases, certain gross receipts should be disregarded in determining the sales factor so that the apportionment formula operates fairly to apportion the income of the taxpayer’s trade or business to Idaho. See Rule 570 of these rules.”¹²

Idaho Administrative Income Tax Rule 570.03 provides in pertinent part:¹³

Net Gains: If gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions of this rule, such gains or losses shall be treated as provided in Subsection 570.03 of this rule. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one (1) or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor.

In the Commission’s decision in Docket No. 12715, published in April 1999, the Commission stated as part of its alternative apportionment analysis that “The Tax Commission here decides to follow case law in a number of other states and to allow inclusion of the net proceeds in the sales factor instead of the gross proceeds. The lesson [Redacted] is that one must compute the percentage of business income generated by the intangible activity in question and compare it with the percentage of combined gross receipts from that activity.”¹⁴ According to

¹¹ IDAPA 35.01.01.521.01.

¹² IDAPA 35.01.01.525.03.

¹³ IDAPA 35.01.01.570.03.

¹⁴ The [Redacted] references are to the Appeals of Pacific Tel. & Tel. Co., 1978 WL 3941 (Cal. St. Bd. Eq. 1978) and the Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc., 89-SBE-017, Cal. CCH ¶ 401-740, 1989 WL 95886 (Cal. St. Bd. Eq., 1989).

the ITA, if the gross proceeds from the petitioners' forward contract trading are added to the sales denominator, then between 60.8 percent and 67.9 percent of gross receipts would produce only between 13.6 percent and 21.2 percent of the petitioners' business income. The auditors perceive this as distortive of the sales factor.¹⁵ Additionally, the ITA noted that including only the net proceeds of the trading activity was consistent with the petitioners' reporting of the same transactions on the 10-Ks the petitioners filed [Redacted] as follows:¹⁶

[Redacted]

Both of the two Arizona court decisions¹⁷ cited in the NODD dealt with gross receipts that were part of a corporation's treasury function or were considered the equivalent of a treasury function wherein the "return of principal" component from one company's investment of its excess cash in short-term instruments and typically reinvested the proceeds in similar interest-bearing investments in commercial paper, municipal securities, auction stock, money markets, and Eurodollar investments (Walgreen), and the other company's receipts were from the sale of mortgage loans, and mortgage servicing rights (M.D.C.) were excluded from the sales factor.

V. ANALYSIS

SPECIFIC FINDING #1 – What component of the petitioners' forward contract trades constitute a "gross receipt" for purposes of Idaho's standard apportionment formula?

For the years at issue, Idaho Code section 63-3027(p) governs the sales factor calculation as follows:

(p) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

¹⁵ The modified NODD, explanation page 12.

¹⁶ *Id.* at page 10.

¹⁷ Walgreen Arizona Drug Company v. Arizona Depart. of Revenue, 97 P.3d 896 (2004); M.D.C. Holdings, Inc. v. Arizona Dept. of Revenue, 216 P.3d 1208 (2009).

Idaho Code section 63-3027(a)(5) defines sales as all gross receipts of the taxpayer not allocated under Idaho Code section 63-3027(d) through (h), subsections that deal with allocated income. The term “gross receipts” is not defined within the Idaho Income Tax Act.

Idaho Income Tax Administrative Rule 010.08 states that “Terms not otherwise defined in the Idaho Income Tax Act or these rules shall have the same meaning as is assigned to them by the Internal Revenue Code including Section 7701 relating to definitions of terms.”

Unlike the situation in the California case involving General Mills, wherein the California law did not provide for a definition of gross receipts,¹⁸ Idaho Income Tax Administrative Rule 325.07 (Rule 325.07) provides taxpayers with the following definition:

07. Gross Receipts. (3-15-02)

a. Gross receipts are the gross amounts realized, (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction that produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example: (3-15-02)

i. Repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; (3-15-02)

ii. The principal amount received under a repurchase agreement or other transaction properly characterized as a loan; (3-15-02)

iii. Proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; (3-15-02)

iv. Damages and other amounts received as the result of litigation; (3-15-02)

v. Property acquired by an agent on behalf of another; (3-15-02)

vi. Tax refunds and other tax benefit recoveries; (3-15-02)

¹⁸ See General Mills v. Franchise Tax Bd., 172 Cal. App. 4th 1535, 1543 (Cal. Ct. App. 2009).

- vii. Pension reversions; (3-15-02)
 - viii. Contributions to capital; (3-15-02)
 - ix. Income from forgiveness of indebtedness; or (3-15-02)
 - x. Amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. (3-15-02)
- b.** Exclusion of an item from the definition of gross receipts is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Rules 560 through 595 of these rules. (3-15-02)

In the petitioners' typical [Redacted] forward contract transaction,[Redacted] enters into a master [Redacted] contract with a counter party. Counter parties to [Redacted] contracts include [Redacted] marketers, [Redacted], and [Redacted] banks. Once both parties approve the master [Redacted] contract, the traders employed by each party then engage in the trading [Redacted]. In accordance with [Redacted] trading strategy, [Redacted] traders are authorized to enter into long positions (buyer) and short positions (seller), often simultaneously, with the counter party. In all cases, the counter parties to the contracts schedule the power through a process called "physical" schedules or "book out" schedules. "Physical" schedules are exactly the same as "book out" schedules except that they provide "generator" and "load" details (specific identification of who generates the power and who consumes the power). The combination of these two schedules must always net to zero since [Redacted] can never be the "generator" or the "load" party. In every case, whether in a book-out schedule or a physical schedule, [Redacted] is a seller for resale of the traded energy for physical delivery as required under the contract. [Redacted] either receives or pays money to settle all of its contracts. Both the [Redacted] purchase and the subsequent [Redacted] re-sale are settled with cash. [Redacted] entered into the forward contracts to speculate in future [Redacted] price movements.

Neither side is arguing that the gain or loss on the cash settlements of the forward contracts is not recognized under the Internal Revenue Code or treated as nonbusiness income. Accordingly, what is the “amount realized” on the petitioners’ forward contract trades before reduction by the basis of property sold?

The “gross amounts realized” is not defined in the Idaho Income Tax Act; however, in Rule 325.07.a., in parenthesis following the term “gross amounts realized,” it states “the sum of money and the fair market value of other property or services received.”

As previously mentioned, [Redacted] and the counter party to the forward contract settle the forward contract for cash based upon the difference between the “book-out” price and the contract price. No additional property or services are received as part of the settlement of the forward contract. Thus, when applying the plain language of Rule 325.07, the petitioners are entitled to only include the actual cash received in the calculation of the Idaho sales factor rather than the full contract price of the forward contract trades since no additional money or other property or services were received as part of the transaction. However, since the actual cash received information is not available; the ITA’s use of the [Redacted] business segment operating revenue obtained from the petitioners’ financial statements is a reasonable approximation.

SPECIFIC FINDING #2 – Does including forward contract trades “gross receipts” within the Idaho apportionment factor fairly reflect the petitioners’ business activity within Idaho?

Although the Commission’s finding is that it is the actual cash received on a “booked-out” forward [Redacted] contract is the “gross receipt” under Idaho’s standard apportionment statute, in the event that the court determines otherwise, it is the position of the Commission that

to allow the full contract price in the Idaho sales factor would not fairly represent the petitioners' business activity within Idaho.

The United States Supreme Court stated that “the Constitution imposes no single [apportionment] formula on States . . . and . . . the Court [has] declined to undertake the essentially legislative task of establishing a single constitutionally mandated method of taxation.” Goldberg v. Sweet, 488 U.S. 252, 261 (1989). A “margin of error [is] inherent in any method of attributing income among the components of a unitary business.” Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 184, (1983). Such a formula need not “identify the precise geographic source of a corporation's profits.” Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978). Rather, a state is required to strive for a “‘rough approximation’ of the corporate income that is ‘reasonably related to the activities conducted within the taxing state.’” Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 223 (1980), *quoting* Moorman Mfg. Co., 437 U.S. at 273. Under the standards articulated by the Supreme Court, states are given wide latitude in developing a formula that can be used to apportion the business income of the combined group.

Although states are given wide latitude in fashioning their respective apportionment formula under the United States Constitution, Idaho's apportionment statute recognizes that there are instances in which Idaho's standard apportionment formula does not accurately reflect the extent of the unitary group's business activity in the state of Idaho. Idaho Code section 63-3027(s) provides that:

63-3027. COMPUTING IDAHO TAXABLE INCOME OF MULTISTATE OR UNITARY CORPORATIONS. The Idaho taxable income of any multistate or unitary corporation transacting business both within and without this state shall be computed in accordance with the rules set forth in this section:

* * *

(s) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may

petition or the Tax Commission may require, in respect to all or any part of the Petitioner's business activity, if reasonable:

- (1) Separate accounting, provided that only that portion of general expenses clearly identifiable with Idaho business operations shall be allowed as a deduction;
- (2) The exclusion of any one (1) or more of the factors;
- (3) The inclusion of one (1) or more additional factors which will fairly represent the Petitioner's business activity in this state; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the Petitioner's income.

These provisions are often referred to as “alternative apportionment.” When standard apportionment fails to accurately reflect the unitary business activity that occurs in Idaho, an alternative apportionment formula may be determined.

The application of Idaho Code section 63-3027(s) was the central issue in Union Pacific Corp. v Idaho State Tax Commission, in which the Idaho Supreme Court stated:¹⁹

Idaho Code Section 63-3027(s) provides that the Tax Commission may require alternative apportionment (a) if the allocation and apportionment provisions of the statute do not fairly represent the extent of the taxpayer's business and (b) if the alternative apportionment is reasonable. Before the statutory apportionment can be rejected in favor of an alternative apportionment, either the Commission or the taxpayer must show that the three-part formula does not accurately reflect the taxpayer's business in the State. The party asserting alternative apportionment bears the burden of showing that alternative apportionment is appropriate.¹⁹

In Union Pacific, the Idaho Supreme Court held that it was permissible to apply an alternative apportionment formula that excluded the corporation's sales of accounts receivable from the sales factor denominator.²⁰ The corporation's reporting system included accounts receivable from freight sales under the accrual accounting method but then also included the sales of those same accounts receivable under the cash accounting method.²¹ The Supreme Court held “that the mixing of the two accounting systems to represent but one group of sales is the unusual fact situation that led to incongruous results” in the application of the standard

¹⁹ *Id.* at 575 (citations omitted).

²⁰ *Id.* at 577.

²¹ *Id.* at 574.

formula and supported the use of alternative apportionment.²² The court found that the Commission had “met its burden of showing the appropriateness of an alternative apportionment.”²³ The court concluded “that the apportionment urged by the Commission to delete the proceeds of the sale of the accounts receivable is a reasonable alternative.”²⁴

According to ITA’s calculations, the regulated utility portion of the unitary business employed approximately 1,400 workers generating gross sales of approximately \$972 million to \$1.3 billion for the taxable years in question. This represented approximately 27 percent to 38 percent of total gross receipts, producing 80 percent to 87 percent of the total business income. In contrast, approximately 50 employees were engaged in the forward contract trading activity resulting in 60 percent to 70 percent of the gross receipts while only generating 14 percent to 21 percent of the business income. Thus, the ITA concluded in its NODD that:

[Redacted]

The purpose of the sales factor is to represent the markets for a taxpayer’s goods or services within a given state.²⁵ The apportionment method used by the petitioners in the Idaho returns (i.e., the inclusion of forward trades gross receipts) creates a sales factor that suggests that Idaho constitutes at most 7 percent to 9 percent of the petitioners’ regulated utility market. However, a review [Redacted] and other information filed with Idaho for calendar years 2004 through 2006 would indicate Idaho’s contribution to the petitioners’ regulated utilities activity would be approximately double or triple of that reflected in the petitioners’ sales factor as

²² *Id.* at 576 – 577.

²³ *Id.* at 577.

²⁴ *Id.* at 577.

²⁵ See generally Altman & Keesling, *Allocation of Income in State Taxation*, 126-128 (2d ed. 1950); J. Hellerstein & W. Hellerstein, *State Taxation I: Corporate Income and Franchise Taxes*, ¶ 8.06 [2] (2d ed. 1993 & Supp. 1996/1997).

reported on the Idaho corporate income tax return. More specifically, if one looks at Idaho's market contribution based upon:²⁶

- Gross utility operating revenue, Idaho's contribution would be:
 - 24 percent to 28 percent from its electric utilities with an average for the three year audit period of approximately 26 percent.
 - 16 percent to 19 percent from its natural gas activity with an average for the three year audit period of approximately 18 percent.
 - 21 percent to 25 percent from its combined electric utilities and natural gas activity with an average for the three-year audit period of approximately 23 percent.
- Megawatts generated, it would be 16 percent to 19 percent with an average for the three year audit period of approximately 18 percent.
- Megawatts sold and delivered into Idaho, it would be 26 percent to 39 percent with an average for the three year period of approximately 33 percent.
- Natural gas therms sold, it would be 14 percent to 20 percent with an average for the three-year period of approximately 18 percent.

The distortion caused by the inclusion of the forward contract trades is similar to what happens with the inclusion of a corporation's treasury function activity at gross. The distortion created by both of these functions was due to the mixing of a low-margin voluminous trading activity with a unitary business that is not primarily a trader of derivatives. In this docket, the mixing of [Redacted] and [Redacted] forward contracting trading activity with a regulated utility primarily involved in the business [Redacted] to customers. While the regulated utility

²⁶ FERC Financial Report for period ending 2004, 2005, and 2006 and the Western States Association of Tax Administrators (WSATA) allocation schedules for the periods ending 2004, 2005, and 2006.

apparently involved itself in the trading of some [Redacted] instruments to balance their load requirements, the trading was not its primary business function.

Therefore, in order to fairly reflect the combined group's business activity within Idaho, including the "overall net gain" on the forward contract trading activity, similar to that of a treasury function, in the Idaho sales factor calculation is a reasonable alternative apportionment method. However, since that information is not available, the operating revenue [Redacted] business segment obtained from the petitioners' financial statements is an adequate replacement. The use of the financial statement's operating revenue would result in an Idaho sales factor for the utility business of between 19 percent and 21 percent and thereby satisfies the underlying purpose of the sales factor to represent the petitioners' market within Idaho.

Accordingly, the Commission sustains the ITA's use of the petitioners' financial statement figures as discussed above.

SPECIFIC FINDING #3 – Are the petitioners subject to interest on the additional Idaho corporate income tax liability?

The Commission certainly understands the concerns raised by the petitioners regarding the imposition of interest, especially if it is the Commission requiring an alternative apportionment method; however, unless otherwise allowed by Idaho law (i.e., Idaho Code section 63-3047), the Commission agrees with the Idaho Supreme Court's finding that Idaho Code section 63-3045(c) "is clear and unequivocal when it states that "interest . . . shall be assessed" and "shall be collected." This section is not discretionary, but rather, it is mandatory." Union Pacific R. Co. v. State Tax Comm'n, 105 Idaho 471, (1983). Accordingly, the petitioners are subject to interest on the additional corporate income tax liability.

FINDING #4 – Are the petitioners subject to the Idaho Code section 63-3046(d) substantial understatement penalty on the additional tax liability?

After careful consideration of the facts and circumstances that lead to the additional tax liability asserted by the ITA in the modified NODD, the Commission declines to assert penalty in accordance with Idaho Code section 63-3046(d)(7).

THEREFORE, the Notice of Deficiency Determination dated January 22, 2010, as modified by the ITA on January 13, 2011, and directed to the petitioners is hereby AFFIRMED AS MODIFIED by this decision.

IT IS ORDERED that the petitioners pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2004	\$184,137	70,154	254,291
2005	\$255,198	81,832	337,030
2006	\$343,114	88,226	<u>431,340</u>
		TOTAL DUE	<u>\$1,022,661</u>

Interest is calculated through December 15, 2011, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed.

DATED this ____ day of _____ 2011.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2011, 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. _____