BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 22875
[Redacted].,	)	
	)	
Petitioner.	)	DECISION
	)	

Procedural Background

On March 4, 2010, the staff of the Income Tax Audit Bureau (Audit Bureau) of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination (NODD) to deny refund claims [Redacted] (Petitioner) made with amended returns filed for taxable years [Redacted]. These same taxable years had already been audited and protested by Petitioner. The audit of taxable years [Redacted] was already far into the audit and protest process when Petitioner filed the amended returns asserting a new position which resulted in a claims for refunds totaling [Redacted] for the taxable years at issue. Rather than bringing this new issue into the audit that was already underway, the Audit Bureau issued a separate NODD to address this new issue and to deny the refund claim. At the point in time that this decision is being drafted, the Tax Commission has already issued a final decision regarding the prior audit of taxable years [Redacted]. Petitioner has appealed that final decision and [Redacted].

Issues

The primary issue in this case, which resulted in the refund claim, is whether [Redacted] is a "[Redacted]" under the definition provided in IDAPA 35.01.01.582 (Income Tax Rule 582). Petitioner, in its amended returns, took the position that [Redacted] is not a financial institution.

In the amended returns, Petitioner excluded some unitary insurance companies that had been included in the original returns. The Tax Commission has already stated its position regarding this issue in the final decision of Petitioner's prior audit for these taxable years

(Docket numbers [Redacted]). The claims for refunds in the amended returns resulting from the exclusion of unitary insurance companies that were not subject to an Idaho premium tax are hereby denied.

The results of [Redacted] audits also resulted in additional tax being asserted in the NODD. The Audit Bureau has spoken with Petitioner regarding this issue. The amount of additional tax due as a result of the [Redacted] adjustments will be determined once [Redacted] the correct apportionment fractions are known.

In Petitioner's protest of the NODD in this case, Petitioner also objected to: the inclusion of insurance affiliates in the combined group; the denial of deductions taken for dividends received from the [Redacted]; and the Audit Bureau's treatment of certain investment tax credits. [Redacted]. The Tax Commission has already stated its position regarding these issues in the final decision of Petitioner's prior audit for these taxable years (Docket numbers [Redacted]). These issues [Redacted] and do not need to be readdressed in this decision.

There was a question as to whether Petitioner was still within the period of limitations to be able to file the amended returns. It appears that Petitioner was within the period of limitations to be able to file amended returns.

Background Facts

1. [Redacted]

Petitioner is a [Redacted] business that ope rates in th e sta te of Idaho and m any other states. [Redacted]. The Petitioner uses these [Redacted] to m ake [Redacted]. [Redacted]. Many of th e m embers of the Petition er's [Redacted] bu siness ar e m embers of [Redacted]. Petitioner's [Redacted] business co nsists of m any entities that were in cluded in th e com bined Idaho tax return. The entity that is the primary focus of this decision is [Redacted].

Petitioner h as stated th at [Redacted] is "[Redacted]." [1] However, a web search on the [Redacted] website does not show [Red acted] as being a [Redacted] dealer. [2] The FINRA BrokerCheck search and Federal Re serve records do show that during the taxable years at issue, in this case, [Redacted] was the parent of [Red acted] registered as securities bro ker deale rs.[3] However, th e Federal R eserve re cords list [Red acted] en tity type as "Dom estic En tity Oth er."[4] The definition provided for "Domestic Entity Other" states "Domestic institutions that engage in banking activities usually in connection with the business of banking in the United States." [5] Federal Res erve records also show [Redacted] ow ning directly or indirectly [Redacted] other entities which are not broker dealers.[6]-

1 Petitioner's Protest Letter, pg 9 (May 5, 2010).
2 FINRA BrokerCheck search available at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/ (last visited August 4, 2011).
3 [redacted]
4 [redacted]
5 Definition of [Redacted] available at http://www.ffiec.gov/nicpubweb/Content/HELP/Institution%20Type%20Description.htm (last visited August 4, 2011).
[Redacted].

[Redacted] is a wholly-owned subsidiary of [Redacted] [Redacted].[7] [Redacted] is the parent corporation of Petitioner's unitary banking business. Petitioner's 2006 Form 10-K, filed with the SEC, explains:

> [Redacted].[8]

Petitioner's [Redacted] Annual Report further explains:

> [Redacted].[9]

[Redacted] is both a bank holding company and a financial holding company. The Federal Financial Institutions Examination Council website provides general definitions of various financial institutions. A Bank Holding Company is described as:

> A company that owns and/or controls one or more U.S. banks or one that owns, or has controlling interest in, one or more banks. A bank holding company may also own another bank holding company, which in turn owns or controls a bank; the company at the top of the ownership chain is called the top holder. The Board of Governors is responsible for regulating and supervising bank holding companies, even if the bank owned by the holding company is under the primary supervision of a different federal agency (OCC or FDIC).[10]

A Financial Holding Company is described as:

> A financial entity engaged in a broad range of banking-related activities, created by the Gramm-Leach-Bliley Act of 1999. These activities include: insurance underwriting, securities dealing and underwriting, financial and investment advisory services, merchant banking, issuing or selling securitized interests in bank-eligible assets, and generally engaging in any non-banking activity authorized by the Bank Holding Company Act. The Federal Reserve Board is responsible for supervising the financial condition and activities of financial holding companies. Similarly, any non-bank commercial company that is predominantly engaged in financial activities, earning 85% or more of its gross revenues from financial services, may choose to become a financial holding company. These companies are required to sell any non-financial (commercial) businesses within ten years.[11]

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[7] [Redacted].
[8] *[Redacted]*.
[9] [Redacted].
[10] Definition of BHCs and Banking Terms, http://www.ffiec.gov/nicpubweb/Content/HELP/Institution%20Type%20Description.htm (last visited July 19, 2011).
[11] *Id.*

Among the various wholly-owned subsidiaries of [Redacted].[12]

2. The Formula for the Apportionment and Allocation of Net Income of Financial Institutions

a. The apportionment of a financial institution's business income.

In 1994, the Multistate Tax Commission (MTC) issued a model provision for apportioning the income of financial institutions.[13] The MTC recommended that states adopt the provisions by statute or regulation.[14] This proposed financial institution apportionment formula came about through much discussion and input from financial institution industry representatives and various representatives from taxing states.[15]

The Idaho State Tax Commission adopted the MTC's "Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions" in Income Tax Administrative Rule 582.[16]

The model provision for apportioning the income of financial institutions contains variations from Idaho's standard apportionment methods set forth in Idaho Code section 63-3027. A variation that is particularly significant in this case is the difference of including "net gains" versus "gross receipts" in the sales factor of the apportionment formula. Idaho uses a three-factor apportionment formula (with sales being double weighted) to determine a proportionate part of the business income of a unitary business which Idaho will tax.[17] Under

[12] [redacted]
[13] Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FormulaforApportionmentofNetIncomeFinInst.pdf.
[14] Alan H. Friedman, *Final Report of Hearing Officer Regarding Proposed Multistate Tax Commission Formula for the Uniform Apportionment of Net Income From Financial Institutions*, pg 11 (April 28, 1994), *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Final%20HO%20Rpt%20FinInst.pdf.
[15] *Id.* at 5.
[16] IDAPA 35.01.01.582.
[17] Idaho Code § 63-3027(i)(1).

the standard apportionment method of Idaho Code section 63-3027, the sales factor (which is a fraction equal to Idaho sales divided by sales everywhere) uses a measurement of "gross receipts."[18] Under the apportionment method for financial institutions adopted by Income Tax Rule 582, the sales factor (referred to as the "receipts factor" in the financial institution apportionment provisions) uses a measure of "net gains" for most categories.[19] The difference between the measure of gross receipts versus net gains can be very significant. For example, if a person purchased an item for $99 and then sold the item for $100, generally speaking, the gross receipt of the sale would be $100, whereas the net gain of the sale would only be $1.

In this case, the difference between including [Redacted] gross receipts in Petitioner's sales factor, as opposed to including [Redacted] net gains (as Petitioner had done in the originally filed returns), resulted in claims for refunds totaling [Redacted] for the taxable years at issue. The purpose of the sales factor is to reflect the contribution of the market state to the production of the taxpayer's income.[20] In Petitioner's originally filed return for taxable year [Redacted], the numerator of the sales factor was [Redacted] million and the denominator was [Redacted], which resulted in an Idaho sales factor percentage of [Redacted] percent. This apportionment calculation reflects that [Redacted] percent of Petitioner's sales receipts in taxable year [Redacted] came from the state of Idaho. In Petitioner's amended return for taxable year [Redacted] (which included the gross receipts of [Redacted]), the numerator of the sales factor was [Redacted] and the denominator was [Redacted], which resulted in an Idaho sales factor percentage of .098 percent (less than [Redacted] of [Redacted] percent). This apportionment

[18] Idaho Code § 63-3027(a)(5) & (p).
[19] Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions, § 3, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FormulaforApportionmentofNetIncomeFinInst.pdf.
[20] *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).

calculation in the amended return suggests that less than [Redacted] of [Redacted] percent of Petitioner's sales receipts in taxable year [Redacted] came from the state of Idaho. The amended returns for taxable years [Redacted] had similarly significant reductions in the sales factors. When taken together, Petitioners' amended returns with these largely reduced sales factors suggested that Petitioner had attributed too much of its income to Idaho in the original returns, and thus paid too much tax to Idaho, and that Petitioner was entitled to refunds totaling [Redacted] for taxable years [Redacted].

b. Defining a "financial institution."

The [Redacted] "Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions" has an "Appendix A" which is titled "Definition of Financial Institution."[21] The MTC model definition of "financial institution" was given as a starting point for states to decide how they wanted to define financial institutions. [22]

Some states have adopted the MTC's definition of financial institution, or some version very close to it, while some other states have used their own unique definitions.[23] Idaho's definition is a mix. Subsection 03 of Idaho Income Tax Rule 582 very closely mirrors the MTC's definition saying that the entities identified in the list are "Presumed to Be Financial Institutions," while Subsection 02 of Rule 582 provides a detailed definition of "financial institution" which mirrors California's definition of a "financial corporation" found in California Administrative Code title 18, section 23183.

Law and Analysis

[21] Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions, Appendix A, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FormulaforApportionmentofNetIncomeFinInst.pdf.

[22] *Id.*

[23] Examples of some of the states that have adopted definitions very close to the MTC's are Arkansas, Colorado, Oregon, Utah, and Washington. Whereas, examples of some of the states that have their own unique definitions are Alabama, Alaska, California, Hawaii, Kansas, and Minnesota.

1. [Redacted] **is a "financial institution."**

In the Idaho tax returns originally filed for the taxable years at issue, Petitioner treated [Redacted] as a financial institution under Idaho Income Tax Rule 582. Late in the audit of taxable years [Redacted], Petitioner filed amended returns for these taxable years taking the new position that [Redacted] is not a financial institution under Idaho Income Tax Rule 582. Petitioner also argues that, as a non-financial institution, the standard apportionment provisions of Idaho Code section 63-3027 apply and [Redacted] "gross receipts" should be used in the sales factor mixed in with the "net gains" of the rest of the entities in Petitioner's combined Idaho tax return.

a. [Redacted] is presumed to be a financial institution.

[Redacted] is presumed to be a financial institution under Idaho Income Tax Rule 582. Idaho Income Tax Rule section 582.03 provides a list of entities presumed to be "financial institutions." Included in this list is "[a]ny corporation whose voting stock is more than fifty percent owned, directly or indirectly, by any person or business entity described in subsections 582.03.a. through 582.03.f." [Redacted] is a bank holding company as described in Idaho Income Tax Rule section 582.03.a. [Redacted] is a wholly-owned subsidiary of [Redacted]. Thus, [Redacted] is presumed to be a financial institution by Idaho Income Tax Rule section 582.03.g.

Petitioner has argued that the presumption is rebutted by showing that [Redacted] does not fit the definition of financial institutions provided in Idaho Income Tax Rule section 582.02. Their arguments have focused on parsing the definition in Idaho Income Tax Rule 582.02 and arguing that each of the four parts of that definition do not apply to [Redacted].

The Tax Commission holds that once an entity is presumed to be a financial institution by Idaho Income Tax Rule section 582.03, the only way to be excluded is by way of Idaho Income Tax Rule section 582.04. Idaho Income Tax Rule section 582.04 states:

> **04. Exclusion from Rule.** The Tax Commission is authorized to exclude any person from the application of Subsection 582.01 upon such person proving, by clear and convincing evidence, that the income-producing activity of such person is not in substantial competition with those persons described in Subsections 582.03.a. through 582.03.f. and 582.03.h.

The Idaho Supreme Court has explained that clear and convincing evidence is "evidence indicating that the thing to be proved is highly probable or reasonably certain." [24] The Idaho

[24] Idaho Dept. of Health & Welfare v. Doe, 150 Idaho 752, 250 P.3d 803, (2011).

Civil Jury Instructions provide a description of the clear and convincing evidence burden of proof. IDJI 1.20.2 states:

> When I say a party has the burden of proof on a proposition by clear and convincing evidence, I mean you must be persuaded that it is highly probable that such proposition is true. This is a higher burden than the general burden that the proposition is more probably true than not true.

b. Petitioner has not shown by clear and convincing evidence that [Redacted] is not in substantial competition with those persons described in Idaho Income Tax Rule sections 582.03.a. through 582.03.f. and 582.03.h.

Petitioner has failed to provide clear and convincing evidence to prove that [Redacted] is not in substantial competition with entities described in Idaho Income Tax Rule sections 582.03.a. through 582.03.f. and 582.03.h. To the contrary, available facts indicate to the Tax Commission that [Redacted] is in substantial competition with entities described in Idaho Income Tax Rule sections 582.03.a. through 582.03.f. and 582.03.h. In particular, it appears to the Tax Commission that [Redacted] is in substantial competition with bank holding companies described in Rule 582.03.a.[25]

Petitioner's "substantial competition" arguments have focused solely on whether [Redacted] is in substantial competition with the business of national banks.[26] Petitioner has stated that [Redacted] is a licensed broker dealer and investment adviser and has argued that "gross income from principal trades (i.e. where securities are inventory) does not result from

[25] It also appears very likely that [Redacted] is also in substantial competition with national banks described in Rule 582.03.b.

[26] Even under Petitioner's analysis, the Tax Commission's view is that since the Gramm-Leach-Bliley Act of 1999, it has become the "business of national banks" to have their holding companies elect to be financial holding companies so that they can engage in broker dealer activities and offer these services to their customers. [Redacted] is performing this function for Petitioner as Petitioner competes with the other large national banks that also have broker dealers as part of their group and offer these services to their customers.

'competing' activities since national banks cannot market stocks, bonds, debentures, notes and other securities."[27]

Regardless of whether or not Petitioner is in "substantial competition with the business of national banks," it appears to the Tax Commission that [Redacted] is in substantial competition with bank holding companies described in Rule 582.03.a. and, therefore cannot remove itself from the Rule 582.03.g. presumption by way of Rule 582.04. Since the Gramm-Leach-Bliley Act of 1999, bank holding companies can elect to be treated as a "financial holding company" which is then allowed to engage in securities broker dealer activities. 12 USC 1841(p) defines "Financial Holding Company," stating, "For purposes of this chapter, the term 'financial holding company' means a bank holding company that meets the requirements of section 1843 (l)(1) of this title." 12 USC 1843(k)(1) provides that a financial holding company "may engage in any activity, and may acquire and retain the shares of any company engaged in any activity" that is "financial in nature." 12 USC 1843(k)(4) lists activities that are financial in nature and includes "underwriting, dealing in, or making a market in securities." The Federal Reserve website explains:

> A bank holding company or a foreign bank that elects to become or be treated as a financial holding company pursuant to provisions of the Gramm-Leach-Bliley Act that amended section 4(k)(4)(E) of the Bank Holding Company Act, may engage in securities underwriting, dealing, or market-making activities. The financial holding company must notify the Board within thirty days after commencing these activities.[28]

Most of the bank holding companies of the largest commercial banks have elected to be "financial holding companies." [Redacted] are holding companies of several of the largest

[27] The Tax Commission questions whether [Redacted] is actually a licensed broker dealer; no evidence has been provided to prove that it is. As discussed above in the background facts, Federal Reserve and FINRA records seem to indicate that [Redacted] is not a registered broker dealer (although it does appear that it was the parent of three LLCs which were registered broker dealers during the taxable years at issue).

[28] FRB: About Securities Underwriting and Dealing Subsidiaries, *available at* http://www.federalreserve.gov/bankinforeg/suds_about.htm (last visited August 4, 2011).

commercial banks and each has elected to be treated as a "financial holding company."[29] Each of these bank holding companies directly or indirectly holds a securities broker dealer subsidiary.

[Redacted] appears to be in substantial competition with bank holding companies described in Idaho Income Tax Rule section 582.03.a. If it is true that [Redacted] is a registered broker dealer, then it follows that [Redacted] has been engaged in "underwriting, dealing in, or making a market in securities." Bank holding companies that elect to be treated as financial holding companies can engage in "underwriting, dealing in, or making a market in securities." As discussed above, most of the bank holding companies of the largest commercial banks have elected to be treated as financial holding companies so that they can engage in the types of activities that Petitioner states that [Redacted] engages in. Thus, if [Redacted] is a broker dealer, then it appears it is in substantial competition with bank holding companies described in Income Tax Rule section 582.03.a.

Petitioner has not presented evidence to establish [Redacted] actually is a registered broker dealer. As discussed above in the background facts, Federal Reserve records seem to indicate that [Redacted] is not a registered broker dealer, but rather is classified as a "Domestic Entity Other" that engages in banking activities. If this is the case, then [Redacted] is likely also in substantial competition with banks described in Idaho Income Tax Rule section 582.03.b.

The Federal Reserve records show [Redacted] as the parent company of [Redacted] entities.[30] Three of which are shown to be securities broker dealers. The other nine entities are: [Redacted] If [Redacted] was the parent of various broker dealers, insurance companies, and

[29] See search results for each entity *available at* http://www.ffiec.gov/nicpubweb/nicweb/SearchForm.aspx; *also see* FRB: Securities Underwriting and Dealing Subsidiaries, *available at* http://www.federalreserve.gov/bankinforeg/suds.htm.

[30] [redacted]

other financial companies, this appears very similar to the activities of a bank holding company that has elected to be treated as a financial holding company; once again suggesting that [Redacted] is in substantial competition with bank holding companies described in Income Tax Rule section 582.03.a.

In conclusion, [Redacted] is presumed to be a financial institution under Idaho Income Tax Rule section 582.03.g. Petitioner has not rebutted the presumption because Petitioner has failed to provide clear and convincing evidence to prove that [Redacted] is not in substantial competition with entities described in Idaho Income Tax Rule sections 582.03.a. through 582.03.f. and 582.03.h. Further, available facts indicate to the Tax Commission that [Redacted] is in substantial competition with bank holding companies described in Income Tax Rule section 582.03.a.

2. Even if [Redacted] **did not fit the Idaho definition of financial institution, mixing its gross receipts in the sales factor fraction with the net gains of the other entities in the combined group produces distortive results that do not fairly reflect Petitioner's business activity in Idaho.**

a. Alternative apportionment under Idaho Code section 63-3027(s).

Idaho Code section 63-3027(s) provides:

> (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 for or the state tax commission may require, in respect to all or any part of the taxpayer'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 taxpayer's business activity in this state; or
> (4) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The application of Idaho Code section 63-3027(s) was the central issue in Union Pacific Corp. v Idaho State Tax Commission case Idaho Supreme Court.[31] The court stated:

> 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.[32]

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.[33] 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.[34] The Supreme Court held "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 formula and supported the use of alternative apportionment.[35] The court found that the Tax Commission had "met its burden of showing the appropriateness of an alternative apportionment."[36] The court concluded "the apportionment urged by the Commission to delete the proceeds of the sale of the accounts receivable is a reasonable alternative."[37]

b. Mixing a method that measures the "gross receipts" of [Redacted] with a method that measures only the "net gains" of the rest of the entities in the group creates an unusual fact situation that leads to incongruous results in apportioning Petitioner's income.

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[31] Union Pacific Corp. v Idaho State Tax Commission, 139 Idaho 572, 83 P.3d 116 (2004).
[32] *Id.* at 575 (citations omitted).
[33] *Id.* at 577.
[34] *Id.* at 574.
[35] *Id.* at 576 – 577.
[36] *Id.* at 577.
[37] *Id.* at 577.

Petitioner's sales factor computation that mixes [Redacted] gross receipts with the net gains of the rest of the group produces a result that does not fairly reflect Petitioner's business activity in Idaho. The difference between the measure of gross receipts versus the measure of net gains can be very significant. For example, in this case, [Redacted] gross receipts were [Redacted] (which they included in the sales factor denominator in the amended return), whereas [Redacted] net gains were only [Redacted] (the amount included in the sales factor denominator in the original return). In Petitioner's originally filed [Redacted] Idaho tax return, the total everywhere receipts of Petitioner's combined group (i.e. the denominator of the sales factor) was [Redacted]. Then in Petitioner's amended [Redacted] Idaho tax return, when the measure of [Redacted] gross receipts was used, the total everywhere receipts of the group jumped dramatically up to [Redacted]. The amended return method creates a strange factual scenario where [Redacted] represents [Redacted] of the Petitioner's combined group sales factor. The total income of the combined group reported on the federal 1120 forms for all of the entities in Petitioners' combined group for [Redacted]; the portion of that total income that came from [Redacted] percent of the group's total income). There are numerous entities in Petitioner's combined group, and when taken all together, [Redacted] only brought in [Redacted] percent of the total income of the entire group in [Redacted]. One of the largest contributing entities in the combined group was [Redacted], bringing in [Redacted] of the combined group's total income in [Redacted] (which was [Redacted] percent of the group's total income), yet Petitioner's apportionment method has [Redacted] representing [Redacted] percent of the sales factor and [Redacted] representing only [Redacted] percent of the sales factor.[38] The mixed method employed by Petitioner in the amended tax returns creates a strange factual scenario that does not

[38] [redacted]

fairly represent Petitioner's business activities in Idaho; it causes the sales attributes of [Redacted] to be severely over-weighted in the sales factor such that the sales contributions of all the other entities are dwarfed.

The purpose of the sales factor is to represent the markets for a taxpayer's goods or services.[39] The apportionment method used by Petitioner in its amended Idaho returns (i.e. the inclusion of [Redacted] gross receipts) creates a sales factor that suggests that Idaho constitutes, at most, [Redacted] percent (less than [Redacted] percent) of Petitioner's markets and also suggests that [Redacted] constitutes approximately [Redacted] percent of Petitioner's markets for goods or services. The Tax Commission is unable to accept the notion that approximately 90 percent of Petitioner's markets for providing goods or services is in [Redacted] while less than [Redacted] percent is in Idaho. Petitioner is one of [Redacted]. An apportionment method that would treat the single state of [Redacted] as being [Redacted] percent of Petitioner's markets cannot fairly represent Petitioner's business activities in Idaho.[40]

Even after the payroll and property factors are allowed to mitigate Petitioner's extremely distorted sales factor, the apportionment method used by petitioner in their amended return still does not fairly represent its business activity in Idaho. In Union Pacific, the Idaho Supreme Court explained, "The three factors, sales, payroll and property, are used to balance each other, each reflecting a different type of contribution to the business activity and income of the unitary business as a whole."[41] The Idaho Supreme Court continued, "Distortion in one factor, therefore, does not necessarily result in unfair reflection of the business activity in the state; the other two factors may well mitigate the distortive effect of the third, so that, ultimately, the taxpayer's

[39] *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).
[40] *See* similar line of reasoning in Microsoft Corporation v Franchise Tax Board, 139 P.3d 1169, 1178 (Cal. 2006).
[41] Union Pacific at 577.

business activity in the state is fairly represen ted through the com bination of the three factors in the apportionment formula."[42] Looking again at the amended returns for taxable year [Redacted] as an example, Petitioner's combined group had a total property denominator of [Redacted]; only [Redacted] [Redacted] percent) of the property d enominator came from [Redacted]. Petitioner's combined group had a total payroll denom inator of [Reda cted]; only [R edacted] ([Redacted] percent) of the proper ty denom inator cam e from [Redacted]. As stated earlier, Petitioner's apportionment m ethod has [Redacted] represenati ng [Redacted] percent of the com bined group sales factor. Even af ter bringing to gether the p roperty and payroll factors with the sales factor (double weighted), Petition er's apportionm ent method still suggests that [Redacted] is responsible for [Redacted] percent of the busine ss activity and incom e of Petitioner's com bined group. As discussed above, [Redacted] contribute d only [Redacted] percent of the total incom e reported on the federal 1120 forms for all of th e entities in Petitioners com bined group for taxable year [Redacted]. Even after the prope rty and payroll factors have been allowed to "mitigate" the effects of Petitioner's extreme sales factor, Petitioner's apportionment method still cannot fairly represent its business activities in Idaho.

The reasonable alternative to the apportionment method used by Petitioner in its amended returns would be to a pply the f inancial ins titution app ortionment rules to [Redacted] (a s Petitioner d id in its Idah o tax re turn as orig inally filed). All th e othe r en tities in the com bined group are using the measure of net gains for the sales factor; using the measure of [Redacted] net gains would avoid the strange re sults of Petitioner's m ixed m ethod and would fairly reflect Petitioner's business activity in Idaho.

[42] *Id.*

Conclusion

[Redacted] is presumed to be a financial institution by Idaho Income Tax Rule section 582.03.g. Once an entity is presumed to be a financial institution by Idaho Income Tax Rule section 582.03, the only way to be excluded is by way of Idaho Income Tax Rule section 582.04. Income Tax Rule section 582.04 requires Petitioner to provide clear and convincing evidence to prove that [Redacted] is not in substantial competition with entities described in Idaho Income Tax Rule sections 582.03.a. through 582.03.f. and 582.03.h. Petitioner has not presented clear and convincing evidence as required by Idaho Income Tax Rule section 582.04. Even more, available facts suggest that [Redacted] is in substantial competition with bank holding companies described in Idaho Income Tax Rule section 582.03.a. Petitioner has not rebutted the presumption, and [Redacted] is considered to be a financial institution under Idaho Income Tax Rule 582.

Even if [Redacted] did not fit the Idaho definition of financial institution, the Tax Commission would invoke its authority under Idaho Code section 63-3027(s) to require an alternative apportionment method because the apportionment method used by Petitioner in the amended returns does not fairly represent its business activity in Idaho. The reasonable alternative would be for [Redacted] to use the financial institution apportionment measure of "net gains" (just as Petitioner did in its originally filed returns).

THEREFORE, Petitioner's claims for refunds set forth in the amended tax returns for taxable years [Redacted] are hereby denied. As explained above, the issues regarding these taxable years that arose during the first audit will be decided [Redacted].

As mentioned above, the amount of additional tax due as a result of federal adjustments will be determined once [Redacted] the correct apportionment fractions are known.

An explanation of the taxpayer's 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.

Courtesy copies mailed to:

[Redacted]
[Redacted]