BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 23221
[Redacted]	)	
	)	DECISION
Petitioner.	)	
	)	

On June 4, 2010, the Idaho State Tax Commission's (Commission) Income Tax Audit Bureau (ITA) issued a Notice of Deficiency Determination (NODD) to [Redacted] (petitioner) for taxable years 2006, 2007, and 2008. The adjustments proposed by the ITA resulted in additional monies due by the petitioner since some of the nonresident partners elected to have the petitioner pay their Idaho income tax on their behalf at the entity level rather than filing an Idaho nonresident individual income tax return. As such, the ITA seeks payment from the petitioner on behalf of the electing partners for tax, interest, and penalty in the amount of $125,142. The petitioner filed a timely protest and petition for redetermination. The petitioner was informed of its appeal rights. The Idaho Code section 63-3045(2) hearing was held on February 3, 2011. The Commission, after having reviewed the file, hereby issues its decision.

The primary issue in this case is the calculation of Idaho source income with respect to the petitioner's [Redacted] activity conducted both within and without Idaho. Should the petitioner apply the standard three-factor formulary apportionment as a single unitary business or should it be allowed to allocate the net income or loss [Redacted] based upon the physical location of the real property. Additional issues include (1) the add back of state income taxes, (2) expenses allowed as deduction in calculation of the amount of income subject to tax, (3) the amount of partnership attributes to be included in the calculation of the petitioner's Idaho apportionment factor, and (4) the proposed assessment of multiple penalties: the 5% negligence

penalty, the 10 percent substantial understatement penalty, and the 2 percent penalty for failure to have a valid extension.

A. IN GENERAL

The petitioner is a limited partnership based outside of Idaho. According to its federal partnership returns, the petitioner started business in [Redacted], and its principal business activity [Redacted]. The petitioner's partners consist of general partners and limited partners, most of which are individuals with profit/loss ownership interests at the end of each of the taxable years as follows:

[Redacted]

[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]		[Redacted]	[Redacted]
[Redacted]	[Redacted]		[Redacted]	[Redacted]
[Redacted]	[Redacted]		[Redacted]	[Redacted]
[Redacted]	[Redacted]		[Redacted]	[Redacted]
[Redacted]	[Redacted]		[Redacted]	[Redacted]
[Redacted]		[Redacted]	[Redacted]	[Redacted]

As shown above, two of the general partners are also limited partners and are in fact brothers. [Redacted] files an Idaho nonresident individual income tax return. The remaining partners elected to have the partnership, on behalf of the electing partners, remit Idaho income tax on their share of income allocated to Idaho in lieu of the partner filing an Idaho income tax return.

On its federal Form 1065 U.S. Return of Partnership Income, Form Schedule K, the petitioner reported the following activity:

Table 2 [Redacted]	2006	2007	2008
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]		[Redacted]	[Redacted]
[Redacted]		[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

When the petitioner filed its Idaho Form 65 Idaho Partnership Return of Income, it reported the same amounts as shown in **Table 2** as "net business income subject to apportionment." Additionally, the petitioner reported on its Idaho income tax returns a zero Idaho apportionment percentage resulting in none of the income listed in **Table 2** being apportioned to Idaho. Instead, the petitioner treated certain items included in the amounts reflected in **Table 2** as allocable to Idaho rather than subject to apportionment as follows:

[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

It was the income in **Table 3** that the petitioner paid Idaho tax on behalf of the electing partners (except for that portion of the income passed through [Redacted], since he filed an Idaho nonresident income tax return).

In looking at the activity that generated the net income from [Redacted] activity reflected in **Table 2**, it was generated from the petitioner's ownership [Redacted] in other pass-through entities involved in various [Redacted] activities, and other [Redacted]. The petitioner reports its rental real estate activity on [Redacted] Form 8825 Rental Real Estate Income and Expenses of a Partnership or S Corporation. That information is summarized in the following **Tables 4** through **6**:

[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	
[Redacted]	[Redacted]	[Redacted]	[Redacted]

[Redacted]

[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]

[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]		[Redacted]	[Redacted]	[Redacted]

As shown in **Table 5**, the petitioner owns a couple of buildings in Idaho, one of which is leased to a [Redacted] Idaho [Redacted] and the other a commercial office building located in [Redacted] Idaho.

The [Redacted] activity flowing from the petitioner's investment in other pass-through entities is as follows:

[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

The petitioner owned a 4.9968 percent interest in [Redacted] during taxable years 2006 and 2007. [Redacted] and it is the petitioner's share of that activity that is reported as "ordinary income from trade or business activities" in **Table 2** above.

The petitioner owned a 34.44 percent interest in [Redacted] during taxable years 2006 through 2008. [Redacted] is an all-Idaho partnership that owns and [Redacted] a commercial building [Redacted], Idaho.

The petitioner allocated its share [Redacted] net income or net losses to Idaho, but reported none of its income [Redacted] as income allocable to Idaho. Even if the petitioner were to prevail in this matter, the petitioner has additional Idaho income from [Redacted] in the amount of $[Redacted] and $[Redacted] for taxable years 2006 and 2007, respectively.

On July 14, 2011, the petitioner provided the Commission with the following additional documents:

1. [Redacted].

In 2009, [Redacted]. changed its name [Redacted]. However, for purposes of this decision, the company will be referred to as [Redacted].[1]

The petitioner's partnership agreement states that the purpose of the partnership is to "[Redacted]." [2] The petitioner points out that it only engaged [Redacted] with very little buying and selling, along with investments in other partnerships.[3]

As previously mentioned, the general partners of the petitioner [Redacted]: [Redacted]. The petitioner's partnership agreement provides that:

> The General Partners, acting by and through their authorized agents, including affiliates of the General Partners, shall manage the Partnership business in an

[1] Petitioner's letter dated July 14, 2011, page two, item 3.
[2] Restated Partnership Agreement page 1, clause 3.
[3] Petitioner's letter dated July 14, 2011, page 1, item 1.

> efficient manner with salary or compensation as agreed upon by a majority of the Limited Partners' participation interests. The General partners shall have full charge of the management, conduct and operation of the Partnership business in all respects and in all matters.[4]

[Redacted].[5] Although the partnership agreement provides for compensation to the General Partners, no compensation was taken by either of the partners.[6]

The petitioner further explains that [Redacted] is the sole owner and president [Redacted], the company that is the asset manager for the petitioner. [Redacted] is also a 70 percent owner [Redacted]. which acts as the petitioner's [Redacted] manager.[7]

Under the November 1, 2001, "operating agreement" between [Redacted] was its original tax matters member, its liaison with mortgage brokers, appraisers, environmental engineers, and other third parties retained by the [Redacted]. Additionally, [Redacted], and/or his 70 percent owned [Redacted], would be the sole listing [Redacted] in the event the shopping center property was to be sold.

As part of the operating agreement, a separate [Redacted] Agreement was entered into on the same day for the acquisition and development of the shopping center. The [Redacted] agreement was between the petitioner and the LLC wherein the petitioner would acquire a 34.44 percent interest in the [Redacted] property, and the LLC would acquire the remainder. Under the [Redacted] Agreement, [Redacted] would act as legal counsel for the petitioner and the [Redacted].

A third agreement, the Agreement to Contribute to the LLC, was executed on November 1, 2001, as well, wherein no later than the earlier of January 4, 2003, or the closing of a permanent loan transaction affecting the [Redacted] property, the petitioner would contribute

[4] Petitioner's partnership agreement page 5, clause 8.
[5] Petitioner's letter dated July 14, 2011, page two, item 4.
[6] Petitioner's letter dated July 14, 2011, page two, item 4.
[7] Petitioner's letter dated July 14, 2011, page two, item 3.

its undivided 34.44 percent [Redacted] interest [Redacted] to the [Redacted] LLC for an undivided 34.44 percent interest in the [Redacted] LLC.

Under the "management agreement" [Redacted], would act as the agent [Redacted]. However, the agent did not have any power to make any structural changes in the building, or to make any other major alterations or additions in or to any such building or any equipment in any such building, or to incur any expense chargeable to the [Redacted], LLC, other than expenses set forth under the agreement, without prior approval of [Redacted].[8] [Redacted]. was to receive any notices, demands, consents, and reports.[9]

Under the "asset management agreement" between the petitioner and [Redacted]. (an entity owned 100 percent [Redacted], who is also its president); it states that the manager ([Redacted].) is experienced in the operating, developing, [Redacted] managing of [Redacted]investments.[10] The manager will deliver [Redacted] services through its affiliates [Redacted]., [Redacted]., or any other entity that [Redacted] has an ownership interest in.[11] [Redacted] would act as the representative [Redacted]., while [Redacted] would act as the representative for the petitioner when dealing with each other.[12]

In the petitioner's letter dated December 30, 2009, the petitioner attempted to convince the ITA that the petitioner is not in the business [Redacted] as it only owns various investments and pays for [Redacted] its [Redacted] properties. Similarly, it argues that the various pass-through entities that it invests in also pay to have the [Redacted] property managed. Thus, the petitioner is simply a passive investor.

[8] Per Management Agreement, page 13, section 19.
[9] Per management Agreement, page 17, section 29.
[10] Asset Management Services Agreement, page 1, Recitals, item B.
[11] Id, page 2, section 3.3.
[12] Id, page 8, section 11.2

The ITA disagreed with the petitioner assessment of its situation and issued the NODD on June 4, 2010. In its NODD, the ITA argues that the petitioner is engaged in a single multistate unitary "trade or business" and should have applied the Idaho's formulary apportionment provisions to the income subject to apportionment rather than simply allocate the net income from the Idaho rental activity.

Under the ITA's approach, the amount of Idaho source income generated by the petitioner that the petitioner's nonresident partners would either report to Idaho, or if permissible, elect to have the petitioner pay the tax on, is as follows:

Table 7	2006	2007	2008
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

The difference between the amount of income subject to Idaho taxation between the methodology employed by the petitioner in **Table 2** and the ITA in **Table 7** is substantial.

B. THE PETITIONER'S ARGUMENT

The petitioner's representative disagrees with the ITA's use of formulary apportionment and argues in their petition for redetermination dated August 3, 2010, that:

[Redacted]

C. THE ITA'S RESPONSE

The ITA disagrees with the petitioner's use of allocation in identifying the amount of Idaho source income:

> It is inconsistent for the taxpayer to state that they don't dispute that they are transacting business, but then claim that they have no business or business income. Either they are in business, or they are not in business. As previously explained, [the petitioner] transacts business in Idaho — not only by owning and renting property in Idaho, but also as a member of other pass-through entities

conducting business in Idaho.

Idaho law defines business income very broadly. Idaho Code Section 63-3027(a)(1) declares that "business income means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from acquisition, management, or disposition of property when such activities are integral or necessary parts of the taxpayer's business. As will be discussed later, acquisition, management, and disposition of property is not just an *integral and necessary* part of [the petitioner's] business - it is the partnership's *only* business.

Idaho Income Tax Administrative Rule 331.01 provides that business income means income "of any type or class and from any activity" that meets either the transactional test or the functional test. The taxpayers assertion that rental of property is not a business by itself and should only be considered business income if it is part of an operating trade or business is simply incorrect.

Idaho Income Tax Administrative Rules makes it crystal clear that rental income can be business income. Rule 336.02 states that rental income is business income if the property for which the rent was received is or was used in the taxpayer's trade or business and is includable in the property factor.

Rule 263 (relating to determining a partner's taxable income from a partnership that operates in more than one state — as does [the petitioner]) clarifies that rental income can be business income. The rule specifically identifies "Net income or loss from rental real estate activities" as a pass-through items that may constitute business income (Rule 263.03.c.).

The audit position is that [the petitioner's] rental income is business income. Idaho Code Section 63-3027 provides the rules for calculating the Idaho taxable income of any corporation transacting business both within and without Idaho. Those rules are applicable to [the petitioner] because Administrative Rule 280 provides that the principles of allocation and apportionment set forth in Section 63-3027 and related rules shall be applied to determine the Idaho source income of a partnership that operates within and without Idaho.

Section 63-3027(a)(1) provides that income arising from transactions and activity in the regular course of the taxpayer's trade or business is business income, and specifically includes income from the "acquisition, management, or disposition" of property when such activities constitute integral or necessary parts of the taxpayer's trade or business.

[The petitioner] reported on its federal tax returns that its principal business activity is "RENTALS" and that its principal product of service is "REAL ESTATE." Most of the income that [the petitioner] is seeking to treat as non-business is generated in precisely the activity they identified themselves as their

principal business activity.

Since real estate rental is the primary activity of [the petitioner], it is difficult to understand how the income generated in that activity could be anything but business income. The partnership's income from real property rentals are business income under the transactional test because they engaged in rental activities on a regular and continuous basis (Administrative Rule 332). The income is also business income under the functional test because the property used in that rental activity is an integral and necessary part of the business (Administrative Rule 333). In fact, the rental properties that produce the income are the primary assets of the partnership.

[The petitioner] asserts that real property rental income should only be considered business income only if there is an operating trade or business and rental income is incident to that business. That restrictive definition is not found in Idaho law.

The [petitioner] (citing ID 63-3027(d)) implies that Idaho law requires treatment of rent income as nonbusiness income. Idaho Code section 63-3027(d) does address allocation of rent income. However the code makes it very clear that allocation of rent applies only "to the extent that they constitute nonbusiness income." Since the rental income of [the petitioner] is business income, allocation does not apply.

D. LAW AND ANALYSIS

The petitioner is a non-Idaho domiciled limited partnership. The petitioner owns [Redacted] in Idaho [Redacted]. Additionally, the petitioner holds ownership interests in other partnerships that are transacting business within Idaho. Accordingly, the petitioner is transacting business in Idaho as that term is defined in Idaho Code section 63-3023.[13] The petitioner has conceded that it is transacting business within Idaho.[14]

Since the petitioner is transacting business within Idaho, the petitioner is required to file an Idaho income tax return and, in fact, has done so.[15]

A partnership that is transacting business within and without Idaho applies the "principals of allocation and apportionment of income set forth in Section 63-3027, Idaho Code, and related rules to determine the extent of partnership income that is derived from or related to Idaho sources."[16]

Idaho Code section 63-3027(a) states in pertinent part:

> (a) As used in this section, unless the context otherwise requires:
> (1) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitutes integral or necessary parts of the taxpayer's trade or business operations. Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitutes an integral part of the taxpayer's trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary.
> (2) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.
> (3) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

[13] References to Idaho Code or Rules refer to the Idaho Code or Income Tax Administrative Rules in effect for taxable years 2006 through 2008 unless otherwise stated.
[14] Petitioner's letter dated August 3, 2010, page 1.
[15] Idaho Code section 63-3030(a)(9).
[16] Idaho Income Tax Administrative Rule 280 (IDAPA 35.01.01.280).

(4) "Nonbusiness income" means all income other than business income.

(Underlining added.)

Nothing within Idaho Code section 63-3027(a)(1) statutory language explicitly precludes the petitioner's [Redacted] income from [Redacted] activities from falling within the definition of business income, provided however, the income is from transactions and activity in the regular course of the taxpayer's trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitutes integral or necessary parts of the taxpayer's trade or business operations. Therefore, does the petitioner's activity or activities constitute a "trade or business" as that term is used within Idaho Code section 63-3027(a)(1)?

In the petitioner's letter dated August 3, 2010, the petitioner contends that its [Redacted] operations were not a "business" and that the income from the Idaho and [Redacted] property was therefore not "business income" as that term is defined in Idaho Code section 63-3027(a)(1). The petitioner argues that the ITA has failed to show the petitioner any case similar to its facts and circumstances wherein rental activity was treated as a business.

In the alternative, the petitioner argues in their July 14, 2011, letter, that even if the rental operations were a business, the formula apportionment provisions of Idaho Code section 63-3027 would not require a single apportionment of the Idaho and non-Idaho [Redacted] activity because the various [Redacted] activities are not unitary with each other. According to the petitioner, "the various [Redacted] properties [Redacted] are each managed separately and have their own management report – there is nothing that ties any of the properties together other than common (passive) ownership."[17] The petitioner cites Appeal of Unitco, Inc., Cal.St.Bd. of Equal., June 21, 1983, as an example of such a situation which it believes its operations should

[17] Petitioner's letters dated August 3, 2010, and July 14, 2011.

be treated in the same fashion as that in Unitco.

In Unitco, the Board ruled that a California corporate taxpayer that, among other things, owned warehouses in Connecticut and Hawaii, a small office building in Colorado, an apartment building in Colorado, a building in Colorado leased to the federal government, a Colorado shopping center, and a 50 percent interest in a general partnership that owned a California high rise office building and store, as well as a California bowling alley, was engaged in several separate lines of businesses rather than a single unitary business. The California taxpayer had turned the management of its directly owned real properties over to an unrelated corporation.[18] The California Franchise Tax Board argued, in part:

> . . . this appeal presents a vivid example of a single corporation engaged in identical activities in four separate states, totally dependent upon appellant's three officers to make the major policy decisions with respect to the activities in each state, and to provide day-to-day guidance as to the activities in some of the states; such a major contribution is clearly indicative of the unitary nature of appellant's operations.

The State Board of Equalization, viewing the situation quite differently than the Franchise Tax Board (respondent), stated:

> Upon examination, the factors relied on by respondent do not reflect such a significant relationship among the rental activities so that they all must be considered as part of a single integrated economic enterprise. At best, the suggested unitary connections are superficial and trivial. We are particularly impressed with the absence of any significant common relationship between appellant's rental activities. Each rental activity is separate and distinct. In no way do any of appellant's rental activities contribute to or depend upon any of the others for their success or failure. Due to the disparate nature of each of appellant's property interests and the lack of any significant common relationship between them, we cannot conclude that these activities constitute a single economic unit. . . . There simply are no significant relationships between appellant's various rental activities which would justify a determination that the activities constituted a single unitary business under either of the two established tests.

[18] Although the corporation was considered unrelated by the California State Board of Equalization, the president and major shareholder of the management corporation appears to have been the president and major shareholder of the California taxpayer.

The Idaho statute is silent on the meaning of the phrase "trade or business" for purposes of Idaho Code section 63-3027. The Idaho Supreme Court noted that when words such as "trade" or "business" are used in a statute, their meaning depends upon the context, or the purpose of the legislature.[19] The Court then discussed the term business from a "natural meaning" as well as in the "commercial sense." The Court provides the following analysis:

> "Trade" commonly connotes the buying, selling, or exchanging of commodities. "Business," however, is a much broader term . . . to signify "that which busies or engages time, attention, or labor as a principal serious concern or interest." Webster's Dictionary. In this sense it embraces everything about which one can be employed.
>
> "Business" in the commercial sense refers to "any activity which occupies the time, labor and attention of men for the purpose of a livelihood or profit." *City and County of Denver v. Gushurst*, Colo.1949, 210 P.2d 616, 618. It implies some constant and connected employment. *Board of Supervisors of Amherst County v. Boaz*, 1940, 176 Va. 126, 10 S.E.2d 498. See also *Smallwood v. Jeter*, 42 Idaho 169, 244 P. 149; (remaining citations omitted)[20]

The context or the purpose of the legislature's use of the phrase "trade or business" in Idaho Code section 63-3027(a)(1) has been interpreted to mean the "unitary business of the taxpayer, part of which is conducted within Idaho."[21]

A "unitary business" is a concept of constitutional law as defined in decisions of the United States Supreme Court.[22] Thus, the definition is found in judicial decisions, not statutes. Different courts have used different words to describe it. Three common attempts to set out a standard or — test of a unitary business are the "three unities test," "dependency and contribution test," and "flow of value/factors of profitability test".

[19] Kopp v. Baird, 79 Idaho 152, 160 (1957), citing Karnuth v. United States, 279 U.S. 231, 239 (1929).
[20] Kopp v. Baird, 792 Idaho 152, at 160 (1957).
[21] Idaho Income Tax Administrative Rule 331.02.a (IDAPA 35.01.01.331.02.a.).
[22] Idaho Income Tax Administrative Rule 325.11 (IDAPA 35.01.01.325.11.).

The three unities approach was developed in Butler Brothers v. McColgan, 111 P2d 334 (Cal. 1941) and provides that the unitary nature of a business is established by the presence of unity of ownership, operation and use.

- Unity of ownership refers to a common ownership structure of a business and its affiliates. As a general rule, in Idaho there must be greater than 50 percent of the voting power of the stock ownership before a group of businesses satisfies the unity of ownership requirement.
- Unity of operation is evidenced by centralized support functions, such as accounting, advertising, legal, personnel, purchasing, research and development, selling or other similar departments.
- Unity of use is shown by a central executive force and a general system of operations. Although unity of use appears to require executive direction to achieve corporate goals, it is unclear to what extent control must be exercised by the central executive force.

The contribution and dependency approach, set forth by the California Supreme Court in Edison California Stores v. McColgan, 183 P2d 16 (Cal. 1947) could be considered the broadest of the various tests to determine whether a unitary business exists. The court stated that when "the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary."

The significant flow of value approach, as set forth in Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 103 S.Ct. 2933 (1983), identifies a unitary business as one that is characterized by a significant flow of value as evidenced by factors such as those described in Mobil Oil Corp. v. Vermont, 445 U.S. 425 (1980): functional integration, centralization of management, and economies of scale (commonly referred to as the factors of profitability).

- Functional Integration – Functional integration refers to transfers between, or pooling among, business activities that significantly affect the operation of the business activities. Functional integration includes, but is not limited to, transfers or pooling with respect to the unitary business's products or services, technical information, marketing information, distribution systems, purchasing, and intangibles such as patents, trademarks, service marks, copyrights, trade secrets, know-how, formulas, and processes.
- Centralization of Management – Centralization of management exists when directors, officers, or other management employees jointly participate in the management decisions that affect the respective business activities and that may also operate to the benefit of the entire economic enterprise.
- Economies of Scale – Economies of scale refers to a relation among and between business activities resulting in a significant decrease in the average per unit cost of operational or administrative functions due to the increase in operational size. Economies of scale may exist from the inherent cost savings that arise from the presence of functional integration or centralization of management. Economies of scale can be present in centralized purchasing and centralized administrative functions.

Idaho Income Tax Administrative Rule 341 acknowledges that "unity can be established under any one (1) of the judicially acceptable tests (Butler Brothers, Edison California Stores, Container, etc.), and cannot be denied merely because another of those tests does not simultaneously apply."

What is common to these various tests is a search for a significant flow of value among the components of a business enterprise that create efficiencies of scale and synergies that cannot be easily measured by separately accounting for the income of each component.

Idaho Income Tax Administrative Rule 343.01 (IDAPA 35.01.01.343.01) states that "business activities that are in the same general line of business **generally** constitute a single unitary business.

Idaho's Income Tax Administrative Rule 340.03 (IDAPA 35.01.01.340.03) does recognize that a single entity can contain more than one unitary business as follows:

> **03. Separate Trades or Businesses Conducted Within a Single Entity**. A single entity may have more than one (1) unitary business. In such cases it is necessary to determine the business, or apportionable, income attributable to each separate unitary business as well as its nonbusiness income, which is specifically allocated. The business income of each unitary business is then apportioned by a formula that takes into consideration the in-state and the out-of-state factors that relate to the respective unitary business whose income is being apportioned.

In fact, the Commission has even cited Unitco with approval in Docket No. 21958, published in September 2010; however, in that docket, the record before the Commission was insufficient to warrant a finding that taxpayer's in-state and out-of-state property were part of the same unitary business. That is not the case in the docket before the Commission.

Based upon the record before the Commission in this docket, including the various agreements involving the acquisition, asset management, property management, etc., documenting the two brothers' activity in the real estate business sector, especially [Redacted] extensive [Redacted] expertise, the Commission finds that the petitioner's various [Redacted] activities within and without Idaho and through various pass-through entities are sufficiently similar to warrant a conclusion that they constitute a single unitary "trade or business." Furthermore, the Commission agrees with its staff that the rental income related to the petitioner's [Redacted] activity is business income as that term is defined in Idaho Code section 63-3027(a)(1). Accordingly, the petitioner's rental real estate income from its [Redacted] activity is business income and must be apportioned in accordance with Idaho Code section 63-

3027 and underlying Idaho Administrative Income Tax rules.

E. MODIFICATIONS TO NODD

On July 14, 2011, the petitioner provided additional factor information from its ownership interests in various pass-through entities. Based upon additional information provided by the petitioner and other information available to the Commission, for purposes of this decision, the additional tax due on the income of the partners paid on their behalf has been modified as follows:

Table 8 – Additional Tax Due	2006	2007	2008
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

The Commission has reviewed ITA's treatment of the state income tax addback and concurs with the ITA's treatment within the NODD.

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). Interest has been updated as identified below.

THEREFORE, the Notice of Deficiency Determination dated June 4, 2010, and directed to the petitioner is hereby AFFIRIMED AS MODIFIED by this decision.

YEAR	TAX	INTEREST	TOTAL
2006	$10,312	2,713	13,025
2007	$9,675	1,868	11,543
2008	$10,279	1,326	11,605
		TOTAL DUE	$36,173

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

Interest is calculated through January 31, 2012, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

An explanation of the petitioner'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.

Copy mailed to:

[Redacted]