

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

[Redacted], ) DOCKET NO. 21626  
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Petitioner. ) DECISION  
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BACKGROUND

The Income Tax Audit Division (Division) of the Idaho State Tax Commission (Commissioner) issued a Notice of Deficiency Determination (NODD) dated October 17, 2008, to [Redacted] (Petitioner<sup>1</sup>) for the tax year ended December 31, 2004, denying a refund request of \$173,459. Also, the Petitioner filed a refund request for the tax year ended December 31, 2005, requesting a refund of \$231,174. On October 16, 2009, the Division issued an NODD denying that refund as well. Both refunds were requested by filing amended returns. The Petitioner filed timely requests for redetermination for each of the NODDs. [Redacted] merged with [Redacted] and changed the name [Redacted] in 2011. On the original income tax returns filed with Idaho, the receipts from the inventory Buy/Sell Agreements were included in the sales apportionment factor net of the cost of the inventory traded. The amended returns included the gross amounts of the transactions.

ISSUE

1. Should the gross receipts from inventory Buy/Sell Agreements be used to calculate the sales apportionment factor [Redacted]?

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<sup>1</sup>Included with the term “Petitioners” are those corporations with an Idaho income tax liability as reflected on the Audit Divisions’ schedules 1100.1 through 1100.3 attached to and made part of the NODD.

## DISCUSSION

The transactions created by the Buy/Sell Agreements are where the Petitioner agrees to deliver a certain grade, quality, and quantity [Redacted] at a future date to a party and, in return, receive an equivalent grade, quality, and amount of oil at that time or some other specified date. The example provided by the Petitioner is for a steady daily volume of equal amounts by both parties. The purpose of the exchanges is to ensure a steady supply [Redacted] to each party's [Redacted] and to reduce transportation costs.

The Petitioner asserts that the exchanges constituted sales and that the full value [Redacted] it received in such exchanges consisted of gross receipts to be appropriately included in the denominator of its sales factor for apportionment. The Division disagrees arguing that the continuous buy/sell exchanges do not complete the earnings process and in effect double the amount of gross receipts for these transactions. The treatment proposed by the Petitioner creates a disproportionately large amount of gross receipts, thereby artificially reducing the representation of the Idaho business activity.

Idaho Code section 63-3027 requires that corporations doing business both within Idaho and one or more other states must apportion a part of their business income to Idaho. Apportioned income is derived by multiplying the Idaho taxable income by the apportionment factor. The factor is the ratio of the Idaho property, payroll, and sales to the everywhere property, payroll, and sales. The sales factor is double weighted, and the sum of the individual factors is divided by four to calculate the apportionment factor. The sales factor is defined in Idaho Code section 63-3027(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. In addition to this statute, there are a

number of Income Tax Administrative Rules that govern how the Idaho apportionment factor is calculated.

Idaho Income Tax Administrative Rule 530 Sales Factor Denominator states:

The denominator of the sales factor includes the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded by Rules 525 through 559 and Rule 570 of these rules. The denominator may not exceed the sum of all the numerators.

In the introduction to the rules pertaining to multistate corporations, the Idaho legislature included some definitions. Rule 325 Definitions For Purposes Of Multistate Rules, states in part:

**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)

\* \* \*

**x.** Amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. (3-15-02)

[Emphasis added.]

A plain reading of Rule 325.07.a.x. is that gross receipts is the amount realized in a transaction that produces income recognized by the Internal Revenue Code as business income.

The buy/sell exchanges the Petitioner engages in, by their own description and example, are an exchange of inventory where there is no recognition of gain or loss when the [Redacted] is exchanged. The swap is not the culmination of the earnings process. Any value or cost differentials resulting from the exchange are treated as inventory and cost of goods sold

adjustments. Any gain resulting from the exchange is not recorded until the commodity is sold to a third party.

The everywhere sales of the Petitioner for taxable year 2004 and 2005 reported on the original Idaho Corporation income tax returns were \$2,371,126,448 and \$3,319,576,505. In the amended returns, the everywhere sales had nearly doubled to \$4,302,281,562 and \$6,214,065,206 by including these exchanges [Redacted] at the gross amounts.

The Petitioner provided a copy of one of their Buy/Sell Agreements described as typical. In that agreement, they agree to deliver a set number [Redacted] daily to the counter party's [Redacted] in exchange for an equal number to be delivered to the Petitioner's [Redacted]. The purpose of the agreement is described as ensuring a steady supply [Redacted] and to reduce transportation costs by acquiring supplies from a closer location. The [Redacted] is then further [Redacted] and sold as products to third parties. Third party sales of [Redacted] products are included in gross receipts already. If the supply [Redacted] becomes more than needed, it may be sold again as [Redacted] to outside third parties. All [Redacted] sales to third parties are already included in the gross receipts.

A pre-hearing phone conference was held on January 17, 2012, with the Director of Taxation for the Petitioner, two outside accountants representing the Petitioner, representatives of the Commission, and a Deputy Attorney General. The Commission reminded the Petitioner's representatives of their continuing right to have an informal hearing before one or more of the Commissioners. No new information was provided. The Commission asked if the Petitioner had considered Rule 325.07.a.x. The Petitioner stated they were aware of the rule and had decided it was not applicable to their activity. They said that the [Redacted][Redacted]did recognize the gross receipts in terms of Internal Revenue Code Section 199. IRC Section 199 allows a

deduction or credit based on the amount of Domestic Production Gross Receipts. In this context, the gross receipts include property that is manufactured, produced, grown, or extracted domestically. The purpose of using gross receipts in the IRC 199 calculation is to determine the level of domestic production, not total sales or business income. The Commission does not agree that the buy/sell exchanges meet the definition of IRS recognition used in Rule 325.07.a.x.

To double the everywhere sales when the transactions involved are not the culmination of the earnings process is not representative of the Petitioner’s business activity in Idaho.

CONCLUSION

After reviewing the applicable Idaho laws and rules, and considering the arguments presented by the Petitioner and the Division, in particular Idaho Income Tax Administrative Rule 325.07.a.x., the inventory exchange transactions presented by the Petitioner do not meet the definition of Gross Receipts.

The Commission agrees with the Division that inventory buy/sell exchanges be included in the net cost of the inventory exchanged in the calculation of the Petitioner’s apportionment sales factors.

THEREFORE, the NODDs dated October 17, 2008, and October 16, 2009, and directed to the Petitioner are hereby AFFIRMED by this decision. The refunds are denied.

<u>YEAR</u>	<u>REFUND CLAIMED</u>	<u>REFUND ALLOWED</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/04	\$173,459	\$0	\$0	\$0	\$0
12/31/05	\$231,174	0	0	0	0

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2012.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2012, 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]

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