

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 25689
[Redacted],	)	
	)	
Petitioners.	)	DECISION
_____	)	

A Notice of Deficiency Determination (NODD) was issued on February 16, 2013, to [Redacted] (petitioners) proposing additional income tax, penalty, and interest for taxable years 2005 through 2008 in the total amount of [Redacted].<sup>1</sup> The Idaho State Tax Commission’s (Commission) Income Tax Audit Bureau (ITA) issued the NODD. The petitioners are requesting a refund in excess of one million dollars and filed a timely petition for redetermination (petition). The petition was assigned to Tax Policy (Appeals) to conduct the redetermination. The Idaho Code section 63-3045(2) hearing was held on April 10, 2014. The Commission, having reviewed the file, hereby issues its decision.

**I. PRIMARY ISSUES**

**Issue 1** - Are the petitioners entitled to a refund of corporate income tax for taxable years 2005 and 2006, relating to the filing of an amended return to claim the Idaho investment tax credit? The Commission upholds ITA’s denial of the refund, but modifies ITA’s NODD to allow for a portion of the ITC to be carried out of taxable years 2005 and 2006 and into taxable year 2007.

**Issue 2** - How should transactions between a corporation and a partnership, that are part of the same unitary business, be treated for purposes of the Idaho Code section 63-3027(p) sales factor component of the Idaho apportionment factor? The Commission finds that various

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<sup>1</sup> The petitioners filed an Idaho Form 41 group return under the name of [Redacted]. The petitioners are those corporations shown on schedules 1100 attached to the NODD.

receipts relating to the transactions between the partnership and the corporation should be removed from the sales factor.

**Issue 3** – Did the former Idaho Code section 63-3023(b) protect certain petitioners from Idaho taxation for taxable years 2005 through 2007? The Commission finds that those petitioners asserting the protection engaged in activity beyond the statutory protection and were therefore subject to Idaho’s jurisdiction to tax.

## II. ABBREVIATIONS

In the remainder of this decision, the following abbreviations will be used for convenience:

“**P**”- [Redacted]: sells [Redacted].

“**A**”- [Redacted]: provides financing and leasing of [Redacted] products.

“**B**”- [Redacted]: provides financing and leasing services on [Redacted].

“**C**”- [Redacted]: [Redacted].

“**D**”- [Redacted]: [Redacted].

“**E**”- [Redacted]: [Redacted].

“**F**”- [Redacted]: [Redacted].

“**G**”- [Redacted]: [Redacted].

“**H**”- [Redacted]: [Redacted].

“**I**”- [Redacted]: A foreign partnership formed outside of the United States that sells inventory to foreign consumers that was purchased from “**P**” or unrelated third parties that had manufactured inventory under “**P**’s” specifications.

“**CFC**”– [Redacted]: a foreign corporation owned 100 percent directly or indirectly by “**P**”.

“P” is the parent corporation of a large group of corporations including “A” through “H”. “P” was the 100 percent indirect owner of a number of “CFC’s” that were the partners in “T” resulting in “P” owning indirectly 100 percent of “T”. [Redacted].

### III. HISTORY

#### 1. In General

The petitioners filed an Idaho form 41 unitary group return for taxable years 2005 through 2008, utilizing the worldwide combined reporting method.

In May 2010, the ITA conducted an audit of the petitioners’ 2005 through 2008 group returns, including any amended group returns for those tax years filed as of the date of the audit. The ITA reviewed the petitioners’ calculation and 1) accepted (with one exception [Redacted]) the petitioners’ calculation of income subject to apportionment, 2) adjusted the petitioners’ calculation of Idaho apportionment factor, 3) asserted that additional corporations included within the combined group were subject to Idaho’s jurisdiction to tax, and 4) allowed Idaho investment tax credit.

#### 2. Idaho Amended Returns

The following Idaho amended income tax returns have been taken into consideration as part of this decision:

Filed April 2009 - amended group returns for taxable years 2005, 2006, and 2007. The amended returns were filed primarily to:

1. Claim for taxable years 2006 and 2007 that the activities engaged in by “P” did not exceed the protection afforded by Public Law 86-272 [Redacted]. During the audit, the petitioners abandoned their claim [Redacted].
2. Claim for taxable years 2005 through 2007 that the activities engaged in by “A” did

not exceed the protection by Idaho Code section 63-3023(b) [Redacted].

3. Claim for taxable years 2005 through 2007 that the sales of inventory, between “P” and “T”, should remain in the Idaho Code section 63-3027(p) sales factor denominator and not be removed as intercompany sales.

The 2008 Idaho group return was not amended. The petitioners took the position in the 2008 timely filed return that “P” was not protected by Public Law 86-272, [Redacted], and the sales between “P” and “T” were includible in the sales factor denominator.

Filed in December 2012 - amended group returns for taxable years 2005, 2006, 2007, and 2008, to claim the Idaho investment tax credit generated by “A”.

Filed in February 2013 - amended group returns for taxable years 2005 and 2006 to report [Redacted] audit activity.

Filed in October 2014 - amended group returns for taxable years 2005, 2006, 2007, and 2008 to include, within the sales denominator, sales of inventory by “T” to “P”.

#### **IV. ISSUE ANALYSIS AND FINDINGS**

##### **A. Issue 1 – Idaho Investment Tax Credit**

The petitioners contend that, for taxable years 2005 and 2006, the ITA incorrectly disallowed their refund claim resulting from claiming the Idaho Code section 63-3029B investment tax credit (ITC) earned by “A”.

When the petitioners filed their original Idaho income tax group return for taxable years 2005 through 2008, “A” did not claim any Idaho investment tax credit. No ITC was claimed by “A” on the amended returns that were timely filed in 2009 for taxable years 2005 through 2007. It was not until the filing of the amended returns in 2012 that the petitioners claimed a refund of tax relating to the ITC earned by “A”.

In the amended returns filed in 2009, the petitioners claimed that Idaho Code section 63-3023(b) protected “A” from Idaho taxation for taxable years 2005 through 2007.<sup>2</sup> The ITA disagreed with the petitioners’ interpretation of Idaho Code section 63-3023(b) and found that [Redacted], “A” had exceeded the protection afforded by Idaho Code section 63-3023(b). During the ongoing discussion with the petitioners over that issue, in 2012, the petitioners raised the possibility that “A” may be entitled to ITC and subsequently provided documentation to support that position. The ITA concluded that “A” could claim the ITC [Redacted] and worked with the petitioners to identify the amount of earned ITC.<sup>3</sup> The right to claim the ITC and the amount of the ITC is not in dispute. What is in dispute is whether or not the petitioners can receive a refund of the tax associated with the ITC claimed in 2005 and 2006.

In the NODD, the ITA allowed the refund of tax associated with the claiming of the ITC for taxable years 2007 and 2008 and disallowed the refund of tax associated with the claiming of the ITC for taxable years 2005 and 2006. The ITA argues that any refund associated with the ITC for taxable years 2005 and 2006 should be disallowed as being beyond the statute-of-limitations for filing of a refund claim. Although the petitioners could claim the ITC, the petitioners were not entitled to a refund of taxes for taxable years 2005 and 2006 in the amount of [Redacted] and [Redacted], respectively.

The petitioners argue that the auditor had agreed to allow “A” to claim the ITC for taxable years 2005 through 2007 if the ITA concluded that the Idaho Code section 63-3023(b) was not applicable to “A”. In 2012, the petitioners provided the ITA with electronic schedules identifying the qualifying assets for taxable years 2005 through 2008. The ITA requested that

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<sup>2</sup> Idaho Code section 63-3023(b) was a special provision for certain types of taxpayers engaged in certain types of financial activities and was repealed effective January 1, 2008. See 2007 Idaho Session Laws, Chapter 59, Section 1, page 141.

[Redacted]

the petitioners amend their previously filed Idaho amended returns to reflect the claiming of the ITC. The petitioners filed the requested amended returns in December 2012. The ITA then sought additional information regarding the qualifying assets; which the petitioners provided. The petitioners argue that under Idaho law, claims for refunds must be filed within three years from the due date of the return, which it complied with. The 2005 and 2006 returns were due on April 15, 2006, and April 15, 2007, respectively. The petitioners had until April 15, 2009, and April 15, 2010, to submit refund claims for taxable years 2005 and 2006, respectively. The petitioners filed refund claims in April 2009; prior to the April 15, 2009, deadline. From the petitioners' perspective, the only reason that the amended returns submitted in 2012 were filed was at the ITA's request, pursuant to discussion with the petitioners as to what amount of the ITC was approved. The petitioners contend that the amended returns filed in 2012 with the ITC were not initial claims for refunds as contemplated under Idaho Code section 63-3072(b), but rather agreed-upon revisions of timely filed amended returns that were updated to reflect adjustments made during the course of an audit.

1. The period for receiving a refund of tax for taxable years 2005 and 2006 had expired.

Idaho Code section 63-3072 governs refund claims of income taxes and it states, in pertinent part:

63-3072. Credits and refunds. (a) Subject to the provisions of subsections (b), (c) and (h) of this section, where there has been an overpayment of the tax imposed by the provisions of this chapter, the amount of such overpayment shall be credited against any tax administered by the state tax commission which tax is then due from the taxpayer, and any balance of such excess shall be refunded to the taxpayer.

(b) Except in regard to amounts withheld as provided in section 63-3035, 63-3035A or 63-3036, Idaho Code, or amounts paid as estimated payments under section 63-3036A, Idaho Code, or amounts paid as backup withholding under section 63-3036B, Idaho Code, a claim for credit or refund of tax, penalties, or

interest paid shall be made within the later of three (3) years of the due date of the return, without regard to extensions, or three (3) years from the date the return was filed. However, with regard to remittances received with an extension of time to file, or a tentative return, a claim for credit or refund of such remittances shall be made within three (3) years from the due date of the return without regard to extensions.

(c) With regard to amounts withheld as provided in section 63-3035, 63-3035A or 63-3036, Idaho Code, or amounts paid as estimated payments under section 63-3036A, Idaho Code, or amounts paid as backup withholding under section 63-3036B, Idaho Code, a claim for credit or refund shall be made within three (3) years from the due date of the return, without regard to extensions, for the taxable year in respect to which the tax was withheld or paid. However, with regard to an individual who is entitled to an extension of time as provided in section 7508 of the Internal Revenue Code, the three (3) year period provided in this subsection for claiming a credit or refund shall be extended by the number of days disregarded under section 7508 of the Internal Revenue Code.

...

(h) Prior to the expiration of the time prescribed in this section for credit or refund of any tax imposed by the provisions of this chapter, both the state tax commission or its delegate or deputy and the taxpayer may consent in writing to extend such period of time. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. When a pass-through entity extends the period of limitations in accordance with the provisions of this subsection the period of limitations for the other taxpayers is automatically extended for the same period for the purpose of claiming a credit or refund of tax, penalties or interest by the other taxpayers reflecting the pass-through entity adjustments. . . .<sup>4</sup>

Idaho Code section 63-3072(b) required the petitioners to file “a claim for credit or refund of tax, penalties, or interest paid within the later of three (3) years of the due date of the return, without regard to extensions, or three (3) years from the date the return was filed” (emphasis added). Idaho Income Tax Administrative Rule 880.03 states “The Tax Commission may not credit or refund an overpayment after the expiration of the period of limitations unless the taxpayer filed a claim before the expiration of the period.”

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<sup>4</sup> Id. (Emphasis added.) The language of Idaho Code section 63-3072 was identical for 2005 and 2006 with amendments made in 2007, 2011, and 2013. The amendments do not have any impact on the issue before the Commission in this docket.

The petitioners filed a timely refund claim in 2009 for taxable years 2005 and 2006 not to claim the ITC earned by “A”, but rather [Redacted] that Idaho Code section 63-3023(b) protected “A” from Idaho taxation. The petitioners’ refund claim relating to “A’s” ITC was not filed until 2012, well beyond “three (3) years of the due date of the return, without regard to extensions, or three (3) years from the date the return was filed.” The statute-of-limitations for filing a refund claim relating to the ITC earned by “A” for taxable year 2005 had already expired before the petitioners even raised the ITC issue in 2012 and expired shortly thereafter for taxable year 2006. Since a waiver, pursuant to Idaho Code section 63-3072(h), was entered into for taxable year 2007, extending the Idaho Code section 63-3072(a) statute-of-limitations, the ITA allowed the refund of tax associated with ITC in 2007.

2. The Commission declines to interpret a Tax Commission Administration and Enforcement Rule as broadly as the petitioner would have the Commission do.

The petitioners offer the Commission another argument as to why the refund of tax associated with the ITC for 2005 and 2006 should be allowed. The petitioners argue that as part of the redetermination process, the petitioners are entitled to raise any issue for consideration pursuant to Tax Commission Administration and Enforcement Rule 325 (A&E Rule 325) dealing with a Notice of Deficiency: Protest Procedures. A&E Rule 325.06 states “Redetermination of any tax or refund due is not limited to the specific issue or issues protested for the taxable year, unless limited by Section 63-3068(f), Idaho Code. (3-20-97)”.<sup>5</sup> The Commission declines to interpret A&E Rule 325.06 so broadly, as to do so would place the rule in conflict with the statute-of-limitations for assessment or refunds contained within Idaho Code sections 63-3068

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<sup>5</sup> IDAPA 35.02.01.325.06.

and 63-3072, respectively. In addition, Tax Commission Administration and Enforcement Rule 001, Title and Scope subsection 03 states that:<sup>6</sup>

Taxable years closed by the statute of limitations remain closed and are not reopened by the promulgation, repeal or amendment of any rule. . . . (3-20-97)

Therefore, when reading the Commission's rules in conjunction with the applicable Idaho statutes, the ability of either party to raise an issue during the Commission's administrative appeals process, for purposes of receiving a refund or asserting an additional assessment, is limited to those issues where the assessment or refund of tax is not foreclosed by the statute-of-limitations contained with Idaho Code sections 63-3068 and 63-3072. For example, in the present case, the statute-of-limitations for refund or assessing additional tax is limited to the issues raised in the amended returns for 2005 and 2006, in contrast to taxable years 2007 and 2008, where no such restriction applies since the statute-of-limitations has not expired due to entering into waivers extending the statute-of-limitations on those years. It is for this reason that the Commission can consider new issues, for purposes of refund or assessment, during the redetermination process for taxable years 2007 and 2008, but not for taxable years 2005 and 2006.

3. Petitioner "A" was not required to share all of the ITC it earned in taxable year 2005 and 2006.

The ITA allowed the petitioners to claim the ITC in 2005 and 2006 in order to calculate the amount, **if any**, which would be allowed as a carryover into an open taxable year. Since a waiver was obtained on taxable year 2007, it is the taxable first year still open to claim a refund of tax for any carryover of ITC from prior taxable years. A review of the NODD supporting calculations reflects that the petitioners did not have any ITC that survived as a carryover into

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<sup>6</sup> IDAPA 35.02.01.001.03.

2007, due in part because “A’s” ITC was used to offset the Idaho income tax liability of the other petitioners included within the combined group. However, “A” was only required to apply its ITC against its Idaho income tax liability in 2005 and 2006 and was not required to share its ITC with other members of the unitary group in 2005 and 2006, unless it elected to do so.

Idaho Income Tax Administrative Rule 710.02 states “Unitary taxpayers. Limitations apply to each taxpayer according to its own tax liability. Each corporation in a unitary group is a separate taxpayer. See Rule 711 of these rules.” Idaho Income Tax Administrative Rule 711.01 provides that “A corporation included as a member of a unitary group may elect to share the investment tax credit it earns but does not use with other members of the unitary group. Before the corporation may share the credit, it must claim the investment tax credit to the extent allowable against its tax liability.” Accordingly, rather than share its ITC in 2005 and 2006, “A” can carryover any of “its” ITC not used against “its” Idaho income tax liability for taxable years 2005 and 2006.

The Commission holds that “A” is not entitled to a refund of the tax relating to the ITC required to be applied against its Idaho tax liability; however, “A” is entitled to carryover the excess [Redacted], as a carryover into taxable year 2007 to be applied against “A’s” 2007 income tax liability, and then applied (shared) against the income tax liability of the other members of the unitary group in 2007.<sup>7</sup>

## **B. ISSUE 2 – IDAHO SALES FACTOR**

During taxable years 2005 through 2008, “P” made sales to “T” and “T” made sales to “P”. “T” was a foreign partnership that was owned by [Redacted] to [Redacted] controlled foreign corporations. The controlled foreign corporations were wholly-owned (directly or

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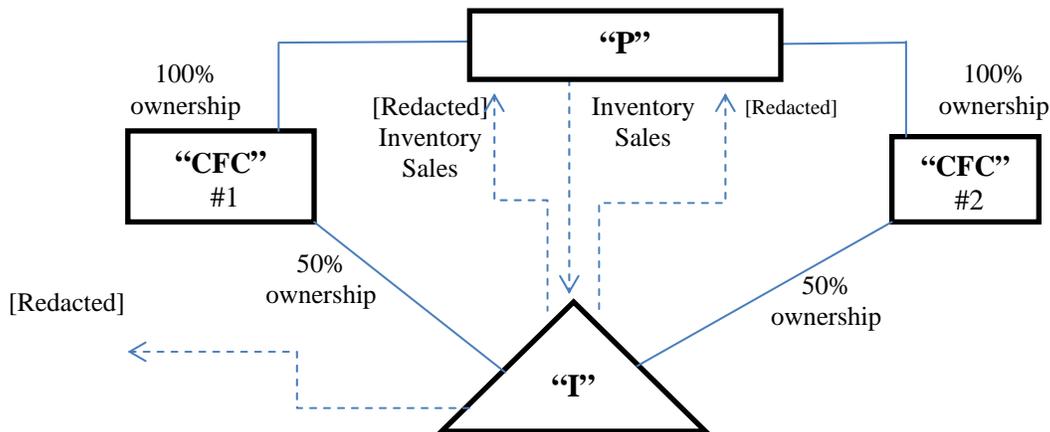
<sup>7</sup> [Redacted].

indirectly) by “P”. “T”, the “CFC’s” that owned “T”, and “P” were all part of the same worldwide unitary business. In addition to the sales of inventory between “P” and “T”, there were other transactions between “T” and either “P” or other corporate members (those that did not have a direct ownership interest in “T”) of the unitary group. **Table 1** below lists the receipts that are at-issue.

<b>Table 1</b>	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]	[Redacted]

[Redacted].<sup>8</sup>

The basic flow of transactions between “T” and the other members of the unitary group, especially “P”, that are at-issue can be illustrated in a flowchart as follows:



“P” sells [Redacted] to its customers located in the United States and to “T”. “T” sells [Redacted] to customers outside of the United States.

[Redacted]. [Redacted].<sup>9</sup>

<sup>8</sup> [Redacted].

<sup>9</sup> [Redacted].

[Redacted].

The ITA relied upon Idaho Income Tax Administrative Rules 450.02, 600.04, 620.04.b, and the Commission's October 7, 2009, published decision in Docket 20983, as requiring the removal of the sale of inventory between the "P" and "I".<sup>10</sup> Additionally, the ITA raises a concern that to allow such sales to be included within the calculation would result in double counting of inventory sales within the apportionment formula. The aforementioned [Redacted], as well as the sales from "I" to "P", were not addressed in the NODD, as these issues were raised post-audit.

The petitioners argue that the various transactions between "P" and "I" and vice versa should be allowed in the sales denominator since Idaho law only requires that sales between members of a combined group (i.e. a sale between "P" and "CFC #1" in the flowchart above) and sales between a partner and the partner's partnership (i.e. a sale between "I" and "CFC #1" in the flowchart above) be eliminated as an intercompany transaction. More specifically, in the petition, the petitioners maintain that:

1. Idaho has no definition of "intercompany" within its income tax statutes or rules;
2. The Commission published decision in Docket 20983 is redacted to the point of not setting precedent;
3. Idaho Income Tax Administrative Rule 620.04.b.'s requirement to remove intercompany factor attributes only applies where the corporate partner "directly owns" a partnership interest in the partnership;
4. Idaho's Multistate Income Tax Audit Manual (MITAM) only requires the intercompany be eliminated to the extent of the corporate partner's interest in the partnership, thus contemplating a "direct ownership" requirement;

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<sup>10</sup> IDAPA 35.01.01.450.02, IDAPA 35.01.01.600.04, IDAPA 35.01.01.620.04.b.

5. The Commission's legal department confirmed the partnership factor treatment in an e-mail dated March 2, 2009; and
  6. Idaho Income Tax Administrative Rules 450.02 and 600.04 addresses transactions between two corporations included within the combined report and not the indirect situation at-issue.
1. Intercompany definition, Docket 20983, MITAM example, and 2009 e-mail.

The Commission agrees that Idaho income tax statutes and underlying rules do not contain a definition of "intercompany" and that the information excised from its published decision in Docket 20983 makes it inapplicable to the current controversy.

The MITAM provides the Commission's audit staff with guidance when encountering a scenario where a corporate partner owns a direct interest in a partnership and is silent with respect to an indirect sale.

With respect to the e-mail in 2009, the Commission received the following inquiry:

[Redacted]

A Commission Tax Policy Specialist (TPS) responded to the question by providing Idaho Income Tax Rule 620 (Rule 620) and an example out of the MITAM. Both Rule 620 and the MITAM example dealt with transactions between a corporate partner and a partnership that the corporation had a direct ownership in. Included in the TPS e-mail was the following disclaimer:

The response contained in this e-mail does not constitute a "formal written Ruling" or declaratory ruling of the Idaho State Tax Commission. If you would like the Tax Commission to issue a declaratory ruling on the issues raised in your e-mail, the Commission requires that your request comply with the provisions of Idaho Administration and Enforcement Rule 110 (IDAPA 35.02.01.110).

Unfortunately, the inquirer did not provide a follow-up seeking clarification [Redacted]. However, even if the TPS had responded in an e-mail that such sales were includable within the sales denominator; such advice would not bind the Commission.<sup>11</sup>

Petitioners' remaining arguments relate to Idaho Income Tax Rules 450 (Rule 450), 600 (Rule 600), and 620 (Rule 620); which represent Idaho law and will be discussed together.

2. Rules are read in conjunction with the Idaho statute.

Rules are read in conjunction with the Idaho statute it relates to.<sup>12</sup> In this case, Rules 450, 600, and 620 relate to Idaho Code section 63-3027, which reads, in part, for the taxable years 2005 through 2008:<sup>13</sup>

**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: . . .

(5) "Sales" means all gross receipts of the taxpayer not allocated . . .

(b) Any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion such net income as provided in this section.

...

(i) (1) . . . all business income shall be apportioned to this state under subsection (j) of this section by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus two (2) times the sales factor, and the denominator of which is four (4), except as provided in paragraph (2) of this subsection.

...

(j) (1) In the case of a corporation or group of corporations combined under subsection (t) of this section, Idaho taxable income or loss of the corporation or combined group shall be determined as follows:

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<sup>11</sup> State of Idaho v. Adams, 90 Idaho 195, 202, 409 P.2d 415, 419 (1965). (The government is not estopped by previous acts or conduct of its agents with reference to the determination of tax liabilities or by failure to collect the tax, nor will the mistakes or misinformation of its officers estop it from collecting the tax.); State Tax Commission v. Johnson, 75 Idaho 105, 112, P.2d 1080, 1084 (1954) (The failure or neglect of the auditor to perform his ministerial duty to change the valuations on the assessment rolls and to properly compute the taxes cannot operate to defeat such liens or to prevent the collection of such additional taxes.)

<sup>12</sup> Idaho Tax Commission Administration and Enforcement Rule 007. IDAPA 35.02.01.007.

<sup>13</sup> Idaho Code section 63-3027 was amended in 2007; however, that amendment is unrelated to the issues in this docket.

(i) From the income or loss of the corporation or combined group of corporations, subtract any nonbusiness income, and add any nonbusiness loss, included in the total,

(ii) Multiply the amounts determined under paragraph (1)(i) of this subsection by the Idaho apportionment percentage defined in subsection (i) of this section, taking into account, where applicable, the property, payroll and sales of all corporations, wherever incorporated, which are included in the combined group. The resulting product shall be the amount of business income or loss apportioned to Idaho.

...

(3) In the case of a corporation not subject to subsection (t) of this section, the income or loss referred to in paragraph (1)(i) of this subsection, shall be the taxable income of the corporation after making appropriate adjustments under the provisions of section 63-3022, Idaho Code.

...

(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.

(q) Sales of tangible personal property are in this state if:

(1) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale, or

(2) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and:

(i) The purchaser is the United States government, or

(ii) The taxpayer is not taxable in the state of the purchaser.

(r) Sales, other than sales of tangible property, are in this state, if:

(1) The income-producing activity is performed in this state; or

(2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

...

(t) For purposes of this section . . . the income of two (2) or more corporations, wherever incorporated, the voting stock of which is more than fifty percent (50%) owned directly or indirectly by a common owner or owners, when necessary to accurately reflect income, shall be allocated or apportioned as if the group of corporations were a single corporation, in which event:

(1) The Idaho taxable income of any corporation subject to taxation in this state shall be determined by use of a combined report which includes the income, determined under subparagraph (2) of this subsection, of all corporations which are members of a unitary business, allocated and apportioned using apportionment factors for all corporations included in the combined report and methods set out in this section. The use of a combined report does not disregard the separate corporate identities of the members of the unitary group. Each corporation which is transacting business in this state is responsible for its apportioned share of the

combined business income plus its nonbusiness income or loss allocated to Idaho, minus its net operating loss carryover or carryback. . . .

Idaho Code section 63-3027 identifies how a multistate corporation engaged in business within and without Idaho calculates its Idaho taxable income or how a unitary corporation engaged in business within and without Idaho calculates its Idaho taxable income. With respect to the latter, if the corporation is part of a unitary business, its Idaho taxation “shall be determined by the use of a combined report.”<sup>14</sup> In both situations, the statutes’ allocation and apportionment provisions apply.<sup>15</sup>

Idaho Code section 63-3027 determines what portion of that income is allocated to a specific state or states as nonbusiness income, and what portion is business income subject to apportionment. Once business income has been determined, Idaho Code section 63-3027(i) apportions it using only those activities that gave rise to the income (the tax base) that is being apportioned. Thus, the components of the payroll, property, and sales factors only reflect the activities that produced the business income subject to apportionment. Property, payroll, and sales related to activities that did not give rise to business income subject to apportionment are not included in the apportionment formula.<sup>16</sup>

Idaho Code section 63-3027’s allocation and apportionment provisions are silent with respect to sales transactions between persons that are part of the same unitary business; however, Rule 450, Rule 600, and Rule 620 do give guidance as to the types of transactions that should be excluded from the sales factor.

Rules 450, 600, and 620 achieve the same purpose and that is to remove transactions

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<sup>14</sup> Idaho Code section 63-3027(t).

<sup>15</sup> Idaho Code section 63-3027(j).

<sup>16</sup> Property factor - Idaho Income Tax Administrative Rule 460.02 (IDAPA 35.01.01.460.020); Payroll factor - Idaho Income Tax Administrative Rule 500.05.a (IDAPA 35.01.01.500.05.a); Sales factor - Idaho Income Tax Administrative Rule 525.01 (IDAPA 35.01.01.525.01).

between members of the same unitary business to avoid manipulation of Idaho Code section 63-3027(i) apportionment factor, especially the sales factor, through the double counting of receipts or the artificial inflation of the sales denominator. This manipulation can occur between a unitary business consisting of a single multistate corporation owing an interest in a partnership or in the context of combined reporting; the latter being the case before Commission.

Idaho Income Administrative Tax Rule 325 (Rule 325) contains definitions of terms used in Idaho Code section 63-3027 and the accompanying administrative rules, including Rules 450, 600, and 620.<sup>17</sup> Rule 325 states, in part:

**325.DEFINITIONS FOR PURPOSES OF MULTISTATE RULES (RULE 325).**

Section 63-3027, Idaho Code. For purposes of computing the Idaho taxable income of a multistate corporation, the following definitions apply: (3-20-97)

01. **Affiliated Corporation and Affiliated Group.** An affiliated corporation is a corporation that is a member of a commonly controlled group of which the taxpayer is also a member. . . Idaho's use of the terms affiliated corporation . . . means a corporation . . . with over fifty percent (50%) of its voting stock directly or indirectly owned or controlled by a common owner or owners. . . (4-6-05)

02. **Allocation.** Allocation refers to the assignment of nonbusiness income to a particular state. (3-20-97)

03. **Apportionment.** Apportionment refers to the division of business income between states in which the business is conducted by the use of a formula containing apportionment factors. (3-20-97) . . .

05. **Combined Group.** Combined group means the group of corporations that comprise a unitary business and are includable in a combined report pursuant to Section 63-3027(t) . . . (3-20-97)

06. **Combined Report.** Combined report refers to the computational filing method to be used by a unitary business which is conducted by a group of corporations wherever incorporated rather than a single corporation. (3-20-97) . . .

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<sup>17</sup> IDAPA 35.01.01.325.

10. Multistate Corporation. A multistate corporation is a corporation that operates in more than one (1) state. For purposes of this definition, state is defined in Section 63-3027(a)(6), Idaho Code. (3-20-97)

11. Unitary Business. Unitary business is a concept of constitutional law defined in decisions of the United States Supreme Court. See Rule 340 of these rules. (7-1-98)

Rule 450 provides guidance with respect the Idaho apportionment factor as it relates to a unitary corporation or a corporation that is conducting business within and without Idaho. Subsection 02 of Rule 450 requires the removal of intercompany transactions “to the extent necessary to properly compute the numerators and the denominators of the apportionment factors of a combined group.” (Emphasis added). Rule 450 (2014 version) states, in part:

**450. APPORTIONMENT FORMULA (RULE 450).**

Section 63-3027(i), Idaho Code.

01. Apportionment Factors. All of a taxpayer’s business income shall be apportioned to Idaho using the apportionment formula set forth in Section 63-3027(i), Idaho Code. The elements of the apportionment formula are the property factor, the payroll factor, and the sales factor. See Rules 460 through 559 of these rules for general rules applicable to these factors. See Rules 560 through 599 of these rules for special rules and exceptions to the apportionment formula. The denominator of each factor may not exceed the sum of the numerators of that factor. (3-20-97)

02. Intercompany Transactions. Intercompany transactions shall be eliminated to the extent necessary to properly compute the numerators and the denominators of the apportionment factors of a combined group. The apportionment factor computation may not include property, payroll, or receipts of any affiliated corporation unless its income is included in the combined report. (3-29-10) . . .

Rule 600 provides guidance relating to a “combined group” and “combined reporting”. Here, again, we find that subsection 04 of Rule 600 requires intercompany transactions to be removed “to the extent necessary to properly reflect combined income and to properly compute the apportionment factor.” (Emphasis added.) Rule 600 (2014 version) states, in part:

**600. ENTITIES INCLUDED IN A COMBINED REPORT (RULE 600).**

Section 63-3027(t), Idaho Code.

01. Combined Report. Each corporation that is a member of a unitary business transacting business within and without Idaho shall allocate and apportion its income to Idaho using a combined report pursuant to Rules 360 through 369 of these rules. . . (4-6-05) . . .

04. Intercompany Transactions. If a return is filed on a combined basis, the intercompany transactions shall be eliminated to the extent necessary to properly reflect combined income and to properly compute the apportionment factor. (3-20-97)

Rule 620 provides guidance relating to partnerships engaged in multistate activity and the reporting of income and certain attributes as a result of a corporation's ownership in a partnership; which would apply to a corporation that is part of a unitary combined group or a multistate corporation conducting business within and without Idaho that was not part of a unitary combined group. Subsection 04.b of Rule 620 requires the removal of intercompany transactions as part of the calculation of the apportionment factors. Rule 620 (2014 version) states, in part:

**620. ATTRIBUTING INCOME OF CORPORATIONS THAT ARE MEMBERS OF PARTNERSHIPS (RULE 620).**

Section 63-3027, Idaho Code.

01. In General. If a corporation required to file an Idaho income tax return is a member of an operating partnership, the corporation shall report its Idaho taxable income, including its share of income from the partnership, in accordance with this rule. For purposes of this rule, the term partnership includes a joint venture. (3-20-97) . . .

03. Multistate Partnerships. If a partnership operates in more than one state, its income shall be apportioned and allocated on the partnership return as if the partnership were a corporation. The allocation and apportionment rules of Section 63-3027, Idaho Code, and related rules apply to the partnership. (3-20-97)

04. Partnership Income as Business Income of the Partner. (3-20-97)

a. Income. If the income or loss of a partnership is business income or loss to a corporate partner, its share of this net business income or loss shall be apportioned together with all other net business income or loss of the corporation. . . . (4-11-06)

b. Factors. A corporate partner's share of the partnership property, payroll, and sales after intercompany eliminations, shall be included in the numerators and the denominators of the partner's property, payroll, and sales factors when computing its apportionment formula. The partner's share of the partnership's property, payroll, and sales is determined by attributing the partnership's property, payroll, and sales to the partner in the same proportion as its distributive share of partnership income if reporting net income for the taxable year or in the same proportion as its distributive share of partnership losses if reporting a net loss for the taxable year. Generally, the partnership's property, payroll, and sales includable in the corporation's factor computations is determined in accordance with Section 63-3027, Idaho Code, and related rules. To determine how the sales attribution rules of Section 63-3027(q), Idaho Code, apply to the sales factor of the corporate partner, the sales of the partnership are treated as if they were sales of the corporation. (3-30-01) . . .

There is no dispute that **"P"**, the **"CFCs"** owning **"I"**, and **"T"** are all part of the same unitary business and that **"P"** and the **"CFCs"** are part of the same combined group that is required to file with Idaho utilizing combined reporting. The petitioners argue that neither Rule 450, 600, nor 620 requires the petitioners to remove the receipts at-issue in this case from the denominator as intercompany. Had the transactions occurred between **"T"** and its **"CFC"** partners, there is no dispute that Rule 620 would clearly require removal of the receipts at-issue. Had transactions occurred between **"P"** and the **"CFCs"** or between **"P"** and **"T"** if **"T"**, were a corporation, there is no dispute that Rule 450 or Rule 600 would certainly require the removal of the receipts at-issue. Should the outcome be any different simply because [Redacted] companies are inserted within the ownership structure resulting in **"P"** owning **"T"** indirectly rather than directly; the Commission believes not.

The inclusion of inventory sales between **"P"** and **"T"** would result in the double counting of inventory sales: once between **"P"** and **"T"** and again when the same inventory was

sold to a customer. With respect to the [Redacted] by “I” from other members of the unitary business included within the combined group, the [Redacted] by “I” to “P”, and the [Redacted] by “I” to “P”, when calculating income, the business income subject to apportionment, the income reported will typically be completely offset by the expense reported by the other member of the combined group. These types of interrelated transactions generally result in no net income included within the tax base. Therefore, the Commission finds that, consistent with its interpretation, as reflected in its existing rules of the Idaho Code section 63-3027(i) calculation of the Idaho apportionment factor, the receipts listed in **Table 1** above should be excluded from the calculation of the Idaho sales factor denominator.

3. The treatment of receipts associated with nonbusiness income provides further support for the exclusion of the **Table 1** receipts.

While Idaho Code section 63-3027 does not specifically provide rules for the principles set forth above relating to intercompany receipts, the Commission’s Income Tax Administrative Rules provide an additional illustration of the need to accomplish such a division of activities in its treatment of nonbusiness income. Because nonbusiness income is allocated, and not apportioned, the activities that give rise to nonbusiness income are similarly excluded from the apportionment formula. Thus, the payroll, property, and sales factors used in the apportionment of business income do not include activities related to the production of nonbusiness income.<sup>18</sup> Only activities that give rise to business income are included in the apportionment formula. This is appropriate because the nonbusiness activities are not related to the business income being apportioned. These same principles apply to the exclusion from the apportionment formula of activities that produce income not included in the tax base. The California Court of Appeal has

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<sup>18</sup> Property factor - Idaho Income Tax Administrative Rule 460.02 IDAPA 35.01.01.460.02; Payroll factor - Idaho Income Tax Administrative Rule 500.05.a IDAPA 35.01.01.500.05.a; Sales factor - Idaho Income Tax Administrative Rule 525.01 IDAPA 35.01.01.525.01.

affirmed this principle.<sup>19</sup> The court held that because intercompany sales are eliminated from the tax base and are not included in the net income subject to apportionment, those sales should be excluded from the sales factor as well. The California court stated:

As to the sales factor, the record indicates that the Board excluded sales from one member of the unitary group to another, as no net income is realized as a result of the internal sales. Thus, the sales factor only included sales to outside purchasers. Chase argues that the sales factor as so computed erroneously distorts Kennecott's sales outside of California. These contentions ignore the fact that while *gross sales* are used to compute the sales factor, only *net income* is subject to the franchise tax. Since no net income is produced by the internal sales, it was not required that they be included in the computation. [Emphasis in the original]

4. The statute-of-limitations has expired on making certain adjustments to the apportionment factor for taxable years 2005 and 2006.

Even if the Commission concluded that the receipts are allowable, the Idaho Code section 63-3068 and 63-3072 statute-of-limitations for assessing or refunding any tax related to the **Table 1** receipts for sales by “**T**” to “**P**”, [Redacted] for taxable years 2005 and 2006 would have expired under the same analysis as discussed above with respect to the refund of ITC for taxable years 2005 and 2006.

5. A&E Rule 325 does not result in the assessment or refund of tax.

Once again the A&E Rule 325.06, dealing with a Notice of Deficiency: Protest Procedures would not come into play and result in a different outcome for taxable years 2005 and 2006 (see prior A&E 325.06 discussion above).

6. The Commission would require the exclusion of the receipts pursuant to its authority under Idaho law.

Even if the receipts were somehow allowable under Idaho Code section 63-3027(i), the Commission would require the exclusion of the receipts pursuant to its authority in Idaho Code

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<sup>19</sup> Chase Brass and Copper Company Inc. v. Franchise Tax Board 70 Cal.App.3d 457, 473 (1977)

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. (Emphasis added.)

The application of Idaho Code section 63-3027(s) was the central issue in the Idaho Supreme Court Union Pacific Corp. v Idaho State Tax Commission case.<sup>20</sup> 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.<sup>21</sup>

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.<sup>22</sup> 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.<sup>23</sup> The 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

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<sup>20</sup> Union Pacific Corp. v Idaho State Tax Commission, 139 Idaho 572, 83 P.3d 116 (2004).

<sup>21</sup> *Id.* at 575 (citations omitted).

<sup>22</sup> *Id.* at 577.

<sup>23</sup> *Id.* at 574.

the use of alternative apportionment.<sup>24</sup> The court found that the Commission had “met its burden of showing the appropriateness of an alternative apportionment.”<sup>25</sup> The court concluded “the apportionment urged by the Commission to delete the proceeds of the sale of the accounts receivable is a reasonable alternative.”<sup>26</sup>

The petitioners’ ownership structure would result in the double counting of inventory sales: once between “P” and “I” and again when the same inventory was sold to a customer. This double counting scenario is similar to the situation contained within Union Pacific and, as in the Union Pacific case, it is appropriate to delete those receipts and not allow those sales of inventory to be double counted within the apportionment formula.

With respect to the [Redacted] by “I” from other members of the unitary business included within the combined group, the [Redacted] by “I” to “P”, and the [Redacted] by “I” to “P”, when calculating income, the business income subject to apportionment, the income reported will typically be completely offset by the expense reported by the other members of the combined group; thus, it is appropriate to require the removal of these receipts from the calculation of the Idaho apportionment factor.

### C. ISSUE 3 – IDAHO JURISDICTION TO TAX

When the petitioners filed the amended returns in 2009, it claimed that Idaho Code section 63-3023(b) protected “A” from Idaho taxation for taxable years 2005, 2006, and 2007. Since the protection from Idaho taxation afforded to certain persons, pursuant to Idaho Code section 63-3023(b), was repealed effective January 1, 2008, the statutory protection would not be available for taxable year 2008.<sup>27</sup>

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<sup>24</sup> *Id.* at 576 – 577.

<sup>25</sup> *Id.* at 577.

<sup>26</sup> *Id.* at 577.

<sup>27</sup> 2007 Idaho Session Laws, Chapter 59, Section 1, page 141.

Prior to the repeal of subsection (b) in 2008, for taxable years 2005 through 2007, Idaho

Code section 63-3023 read as follows;

**63-3023. Transacting business.** (a) Subject only to the limitations of the constitutions of the United States and of the state of Idaho, and except as expressly provided in subsection (b) of this section, the term “transacting business” shall include owning or leasing, whether as lessor or lessee, of any property, including real and personal property, located in this state, or engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit.

(b) Notwithstanding the provisions of subsection (a) of this section, any corporation, bank, trust company, mutual savings bank, savings and loan association, national banking association or other corporation, association or trust organized and existing under the laws of any state or territory of the United States other than the state of Idaho or existing under the laws of the United States including, without restriction of the generality of the foregoing, employee pension fund organizations, charitable foundations, trust funds, real estate investment trusts, or other such funds and trusts engaged in the investment of moneys, and trustees of such organizations, which does not maintain an office within the state of Idaho for any purpose shall not be deemed to be transacting business within the state of Idaho during any taxable year by reason of carrying on in this state any one (1) or more of the following activities:

(1) Creating, acquiring or purchasing of loans, secured or unsecured, or any interest therein;

(2) Collecting and servicing of loans in any manner whatsoever and the making of credit investigations and physical inspections and appraisals of real or personal property securing any loans or proposing to secure any loans;

(3) Soliciting of applications for loans which are sent outside this state for approval; and

(4) Filing of security interests; maintaining or defending any action or suit; holding, selling, assigning, transferring, collecting or enforcing any loans, or foreclosing or other disposition thereof, including acquiring title to property securing such loans by foreclosure, deed in lieu of foreclosure, or otherwise, as a result of default under the terms of the mortgage, deed of trust or other security instruments relating thereto, or the holding, protecting and maintaining of said property so acquired or the disposition thereof.

The petitioners point out that “A” did not maintain an office within the state of Idaho during 2005 through 2007 and that its only activities within the state during these years were financial service activities ([Redacted]). Since “A” did not maintain an office in the state and engaged in one or more of the activities, as delineated in Section 63-3023(b), it is not transacting

business within the State of Idaho in 2005 through 2007. The petitioners believe that when the Idaho legislature changed the law in 2008 by striking down the entire section, the change was not a clarification of existing law; rather, it was an outright change in law that the Idaho legislature and the Commission knew was ambiguous, at best.<sup>28</sup>

The Commission disagrees with the petitioners' interpretation of the statutory language. The statutory language is not ambiguous, as it provides that as long as a certain type of taxpayer is not maintaining an office within Idaho and is engaged in the activities listed within that statute's subsection (b)(1) through (4), the taxpayer is protected from Idaho taxation. However, where the taxpayer is maintaining an office within Idaho or is engaged in activities within Idaho outside of the activities enumerated within the statute, the taxpayer **is not** protected from Idaho taxation. Accordingly, since it has been documented that "A" owned a substantial amount of leased tangible personal property within Idaho, an activity not listed as a protected activity, the Commission finds that Idaho Code section 63-3023(b) does not protect "A" from Idaho taxation.

With respect to taxable year 2008, the petitioners did not include "A" as one of the Idaho corporations subject to Idaho taxation when the Idaho group return was filed. The ITA disagreed and included "A" within the NODD as a corporation subject to Idaho taxation. The Commission sustains the ITA's inclusion of "A" within the NODD as being subject to Idaho income taxation, since the petitioners have not met their burden of showing that the ITA's inclusion of "A" was in error.<sup>29</sup>

## V. MISCELLANEOUS ADJUSTMENTS OR FINDINGS

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<sup>28</sup> [Redacted].

<sup>29</sup> [Redacted].

1. [Redacted].
2. [Redacted].<sup>30</sup>
3. [Redacted].
4. [Redacted].<sup>31</sup>
5. [Redacted].<sup>32</sup>
6. [Redacted].

THEREFORE, the Notice of Deficiency Determination dated February 16, 2013, and directed to petitioners, is hereby MODIFIED in accordance with the provisions of this decision, and as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

Based upon the attached calculations and with interest calculated through September 15, 2015, the petitioners are [Redacted].

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2015.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2015, 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.

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<sup>30</sup> [Redacted].

<sup>31</sup> [Redacted].

<sup>32</sup> [Redacted].

