

2.3. is Unitary by Its Own Binding Water's-Edge Election

In 2007, filed a water's-edge election wherein the pass-through entities, and were treated as members of a combined unitary group and the income from each pass-through entity was treated as business income. This water's-edge unitary group continued to file in this manner through 2012, which is the time period that was owned and controlled by is a corporation domiciled in Mexico.

On April 15 of 2013, the taxpayer filed an amended Idaho return for the 2010 year reflecting a \$218 million subtraction from income relating to they described as "allocated income" and then added \$272,934 which they also described as "allocated income." This amended return was filed after - 2012 announcement that it agreed to acquire

It was also about the time the Department of Justice had issued its Competitive Impact Study requiring - to sell its interest in that it was going to acquire through its acquisition of

The taxpayer stated in its amended return that is a "passive investor in these entities [referring to and and that is "not unitary with The taxpayer's amended return further stated that there are no intercompany transactions between and and no sharing of resources.

In 2013, the gain from sale of was treated as allocable income and not apportionable income.

When a taxpayer makes a water's-edge election under Idaho Code section 63-3027B(a)(4) (2009), the taxpayer takes into account the income and apportionment factors of all affiliated corporations and entities that are in the unitary relationship and that are not excluded by statute in making the combined return. Each affiliate corporation and entity included in the group is deemed to have filed and consented to the election. Idaho Code § 63-3027B(a)(6) (2009). Once the election is made it is binding for all subsequent years. Idaho Code § 63-3027C(a) (1997). And the affiliate corporations and entities are presumed to be part of a unitary group. Idaho Code § 63-3027D(a) (1986).

Taxpayers can change their water's-edge election only after obtaining the Tax Commission's written permission. Idaho Code § 63-3027C(a)(2) (1997). To make a change in their election, the taxpayer must submit a written petition to the Tax Commission at least thirty days prior to the due date for filing the tax return. IDAPA § 35.01.01.643.03. The petition must contain an explanation of the legal and factual basis for making the change and computations showing the Idaho taxable income using the prior reporting method and the proposed reporting method. IDAPA § 35.01.01.643.02.

did not comply with the rules to change its water's-edge election because it did not file a petition with the Tax Commission under IDAPA section 35.01.01.643.02. did file an amended return for the 2010 year which does not meet the requirements of IDAPA 35.01.01.643.02. for two reasons. First, it makes no request to change its water's-edge method nor

does it reference its water's-edge election in any way. Second, it was filed three years after the due date of the return versus thirty days prior to the due date as IDAPA 35.01.01.643.03. requires. Changes to water's-edge methods are only prospective, after petitioning the Tax Commission and obtaining permission, not retroactive by amending a return.

In addition to not complying with the rules, [redacted] is precluded from changing its water's-edge election by the doctrine of election. The doctrine of election

is an equitable principle that generally precludes a taxpayer who makes a conscious election from revoking or amending that election without consent of the Commissioner. [Citations omitted]. The Court has applied the doctrine where (1) there is a free choice between two or more alternatives and (2) there is an overt act by the taxpayer communicating the choice to the Commissioner. *Ag Processing, Inc. v. Commissioner of Internal Revenue*, 153 T.C. 34 at 56 (2019).

Another court stated the doctrine of election applies “where a taxpayer has had a choice of two methods of computing his tax, both legal; where the doctrine of election is applied, he is not permitted to change his mind to the detriment of the revenue.” *Ross v. C.I.R.*, 169 F.2d 483, 494 (1948).

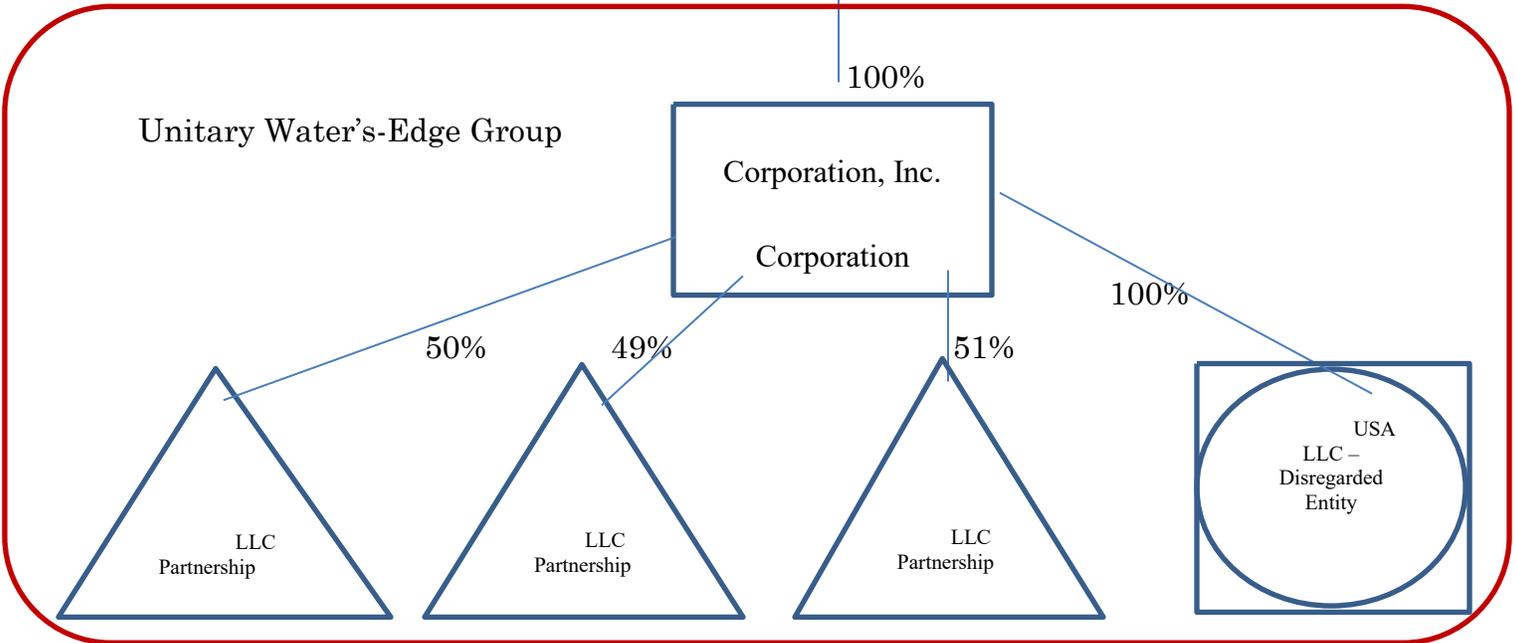
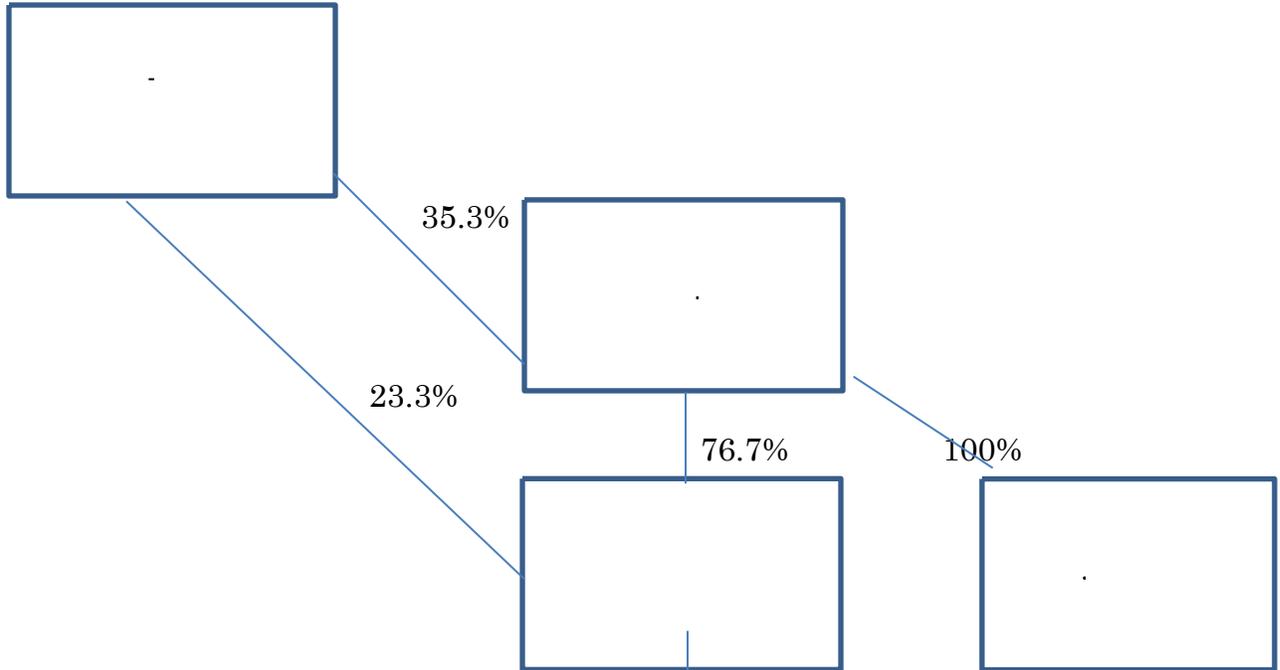
In 2007, [redacted] elected to be taxed as a unitary water's-edge group under IC section 63-3027B versus a world-wide unitary group under 63-3027(a)(6), both are allowable options under the law. [redacted] performed the overt act of filing a water's-edge election by filing Form 14 with its return showing that [redacted] was part of a unitary group and including [redacted] income in its apportionable income. [redacted] filed this way from inception to 2012. Since [redacted] had a choice of two legal options and performed the overt act of including [redacted] in its unitary water's-edge group, the doctrine of election bars them from changing it. Therefore, the new owner [redacted] is precluded from changing the election to avoid paying tax on the gain it received. In other words, the taxpayer cannot be unitary for a water's-edge election and non-unitary when it recognizes a gain on the sale of a unitary member.

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2.4. is Unitary with and Because of Its Ownership Bonds and Its Interactions with the Affiliate Group Members.

2.4.1. The Following Facts Show the Unitary Ownership Bonds and Intercompany Transactions.

The ownership structure of and before the - acquisition was as follows:



The 2012 transfer pricing report described the companies in the combined group as performing the following functions and shows a unitary relationship.

The report states “ -USA agrees to provide administrative and consulting services to the U.S. Affiliates on behalf of -MX as the functions of the U.S. Affiliates directly benefit MX.” The U.S. affiliates are and and through USA, is providing service that benefit

S.A.B. de C.V. is the global parent company to the entities which distribute ten brands of in Mexico and to one-hundred and eighty countries worldwide. It earned \$7.1 billion in net sales in 2012. In addition to producing its own brands of it imported - brands and produced and distributed

is a Mexican entity which owns the brands, trademarks, tradenames, and logos of the group.

is a U.S. entity that functions as a holding company for its partnership interests and the disregarded entity USA.

USA, LLC a performs accounting, IT, supply chain management, sales and brand strategy, customer service and human resource services on behalf of to the U.S. companies of and This appears to be a disregarded entity and is treated as a division of

LLC is a joint-venture partnership which performs carbon dioxide extraction for products that are used in process.

LLC is a joint-venture partnership which performs routine processing based in Idaho Falls, Idaho. processes and supplies exclusively for

is a joint venture entity which imports and sells brand and promotional products in the U.S. and in 2012 had \$2.7 billion in sales.

The report covers the services that USA provides in-behalf of to the and which are the companies located in the United States.

Specifically related to USA provides supply chain management, quality control, sales and brand strategy, and distribution services on behalf of The report describes sales and brand strategy services as meeting with customers on behalf of to facilitate sales, performing end-user analysis, and planning promotion events, protecting trademarks, trade names, and logos, consulting with U.S. management teams regarding financial results and performance indicators. Distribution includes distributing branded merchandise to retailers and wholesalers. Quality control includes control of display items and merchandise. Supply chain management consists of sourcing of retail products (e.g., apparel, wear, coolers, gifts) and display items.

provides the tradenames, trademarks, and logos which are used and managed by and USA.

Per the report, the accounting, IT, and human resource services appear to be provided to and

The intercompany agreements show the unitary relationship between and and The intercompany agreements affecting where is a party are as follows:

- Joint-venture agreement between (partner/member), a subsidiary of Inc. and (partner/member) a subsidiary of This agreement governs the activities, management, and capital structure of
- Sub-License agreement with This agreement grants exclusive rights to to use its trademarks in the U.S. for selling, advertising, marketing, and promoting product. is a subsidiary of
- Importer Agreement with . This agreement provides that will have exclusive rights to sell product in the U.S. is a subsidiary of
- Administrative Services Agreement with This agreement provides that will provide various services to and will lease office space to house the personnel providing the services. It appears that the services provided were most of the services performed by with the exception of those provided by the Board of Directors and USA.

The joint-venture agreement provided that the Board of Directors will consist of eight directors, four are appointed by and four are appointed by The directors received zero compensation for their services on board. None of the directors was an employee of but consisted of officers and employees of and Two of the directors were to serve as Co-Chairman of the board, one appointed from and one appointed from The layout of the board is depicted in the table below.

Name	Appointed by	Role	Employer – Role
		Co-Chairman & Director	– CEO
		Director	– executive over marketing

Name	Appointed by	Role	Employer – Role
		Director	attorney
		Director	executive over operations
		Co-Chairman & Director	CEO
		Director	attorney
		Director	officer
		Director	employee

Audit Committee Members

Name	Appointed by	Role	Employer
		Committee Member	
		Committee Member	CFO
	Brands	Committee Member	Brands
	Brands	Committee Member	Brands

The joint-venture agreement requires the board to meet quarterly and provides the following:

- Only the Board of Directors have power to bind unless the directors delegate power to another.
- Each director is entitled to a single vote.
- All eight directors must approve modifications or departures to the Stub Period Business Plan, Strategic Pricing Initiative, any licensing, purchasing or sale of brands, amendments

to the Certificate of Formation, changes in capital structure, dissolution, bankruptcy filing, or assignments for a creditor. Also, they must approve material changes in tax policy, any borrowings or security interests, capital expenditures in excess of \$1 million individually or \$5 million annually outside of the Business Plan, any acquisition of assets or equity outside of business plan, any asset dispositions in excess of \$250K, any insider business that would restrict from making its mandatory distributions, determinations to terminate the President of appointments of President or Co-Chairman, material changes in the strategic direction of electing officers of and approving the “Stub Period Business plan” and the annual “Business Plan.”

- Members can remove a director at any time without cause.
- Members receive monthly distributions of all available cash in proportion to their percentage interests in
- The “Deadlock” provisions provide that disputed matters will be referred to the Chief Executive Officers of and and to the extent the matter involves the Business Plan and is not resolved by the CEOs, then would operate under the previous year’s plan until the matter is resolved.

From reviewing the minutes of the Board of Director meetings, the following was ascertained:

- Generally, all eight directors were present at each of the quarterly meetings.
- The board would review the Audit Committee report and the matters covered therein.
- They reviewed and approved litigation, regulatory and compliance reports.
- They reviewed and approved current year industry updates and business outlooks.
- They reviewed and approved sales initiatives and designs.
- They reviewed and approved marketing updates.
- They reviewed and approved quality updates, new products, and packaging.
- They reviewed and approved profit and market-share results for profit sharing, short-term incentive compensation, and long-term compensation.
- They reviewed and approved that was to provide an “advancement of fees in connection with the December 2009 lawsuit between the Company’s joint venture partners.” MINUTES OF QUARTERLY MEETING OF THE BOARD OF DIRECTORS OF LLC February 11, 2010 – Chicago, Illinois.
- General business discussions which included the following subjects: Wholesaler days on hand, government and trade relations support, balance of the year forecast, new advertising. MINUTES OF A QUARTERLY MEETING OF THE BOARD OF DIRECTORS OF LLC May 20, 2010.
- The approval of changes to the Importer Agreement and Sub-License Agreement.

The Audit Committee would cover matters like the following:

- Prior period financial results,
- Audit results from PwC,
- Business process review of the operational audit,
- The current years business plan,

- Status update on the Company’s Information Strategic Sourcing service level agreement,
- Business Interruption insurance,
- A report from the Company’s Compliance Committee, and
- The closing of sales offices. See MINUTES OF A QUARTERLY MEETING OF THE AUDIT COMMITTEE FO THE BOARD OF DIRECTORS OF LLC September 2, 2010.

It should be noted that sometimes other employees of _____ or _____ were present at various board or committee meetings. These persons included _____ (_____) _____ (_____) _____ (_____) _____ and others. The other committees consisted of the Audit Committee and the Benefits Committee.

The _____ 2013 and 2012 apportionment schedules showed that _____ had property, payroll, and sales in Idaho. In 2011 and 2010, _____ had property and sales in Idaho. The 2013 through 2015 _____ apportionment schedules show that _____ had property and payroll in Idaho. _____ had throwback sales sitused to Idaho (see “Idaho Sales” below).

To ascertain the magnitude of the intercompany transactions between the _____ group (this includes _____ and _____ and _____ the parent company in Mexico, the following chart shows the transactions of the _____ group with the _____ world-wide group. This chart is based on federal forms 5472 “Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business” which were attached to the Idaho returns.

Year	Reporting Corp.	Ultimate Shareholder	Number of Transactions	Total of All Transactions
2010	_____ Corp.	_____	14	\$40,142,146
2011	_____ Corp.	_____	10	\$17,048,086
2012	_____ Corp.	_____	9	\$21,405,107

The respective payments from the table above are for the following items:

Year	Inventory	Freight Billing	Premium	Fees for Services	Royalties	Other
2010	\$19,524,185	\$0	\$13,423	\$20,538,016	\$44,352	\$22,170
2011	12,772,241	0	0	4,200,000	75,845	0
2012	14,943,882	2,112,547	0	4,200,000	148,678	0

Because of the taxpayer’s water’s-edge election, the law limits the group combination to those companies that file a federal return or are members of a federal consolidated group and are

part of a unitary group which have not filed an IRC section 936 election. Idaho Code section 63-3027B(a). The taxpayer has not filed any IRC section 936 elections.

2.4.2. Constitutional Provisions Showing Idaho is Properly Asserting its Jurisdiction to Tax a Unitary Business

The Due Process clause of the Fourteenth Amendment requires a minimal connection between the interstate activities of the taxpayer and the taxing state and a rational relationship between the income attributed to the state and in intrastate values of the enterprise. *Mobile Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 at 437-38 (1980 S.Ct.). The connection or nexus exists if the corporation carries on business within the State. *Id.* At 438. In this case, [redacted] has availed itself of carrying on business in Idaho because the activity of [redacted] and [redacted] both have property, payroll, and sales in Idaho. Because [redacted] and [redacted] are partnerships, their sales, property, and payroll factors flow through to the partners. IDAPA § 35.01.01.620.

2.4.3. [redacted] Is a Member of a Unitary Business

2.4.3.1. Law

Once the taxing State establishes nexus, the State is permitted to tax an apportioned share of the corporation's multistate business, if the business is unitary. *Allied-Signal, Inc. v. Director of Taxation*, 504 U.S. 768 at 774 (1992 S.Ct.). A state may not tax a nondomiciliary corporation's income if it is from a discrete business activity that is not related to the business conducted in the taxing state. *Id.* This is based on the "principle that the State's power to tax an individual's or corporation's activities is justified by the 'protection, opportunities and benefits' the State confers on those activities." *Id.* At 779. However, if the out-of-State activities of the unitary business are related to the in-State activities, the unitary business is taxable based on its apportionable share. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 166. (1983 S.Ct.).

One set of activities the courts have looked to determine if a business is unitary is the "factors of profitability." *Mobile* 445 U.S. at 438. These factors consist of "functional integration, centralization of management, and economies of scale." *Id.* A second set of activities the Court has found to be unitary is a vertically integrated business which had various components (e.g., manufacturing, sales, etc.) performed in different jurisdictions. *Container Corp.* 463 U.S. at 166. A third set of activities the Court has found to be unitary was "similar enterprises operating separately in various jurisdictions but linked by common managerial or operational resources that produced economies of scale and transfers of value." *Id.*

The underlying principle for a unitary business is that there be some bond of ownership or control uniting the business(s) and that the out-of-state activities be related to the in-state activities. *Id.* "The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation." *Id.*

The factors of profitability consist of functional integration, centralization of management and control, and economies of scale. *Mobile*, 445 U.S. at 438. Functional integration exists where there are important links among the operating departments which may offset risks and imbalances in other departments. *Exxon Corporations v. Wisconsin Department of Revenue*, 447 U.S. 207, 225 (1980 S.Ct.). It also exists where there is “[S]ubstantial mutual interdependence” or there is “considerable interplay” between the members which can come from a substantial flow of goods, intercompany loans, providing technical assistance, and/or acting in a supervisory role by providing general guidance. *Container Corp.*, 463 U.S. at 179.

The Court has found centralization of management and control to exist where “high officials of appellant gave directions to subsidiaries for compliance with the parent’s standard of professionalism, profitability, and ethical practices.” *Container Corp.*, 463 U.S. at 177. Also, the Court found centralization of management to exist when there was considerable interplay between the parent and the subsidiary in the area of corporate expansion. *Id.* at 179. Additionally, centralization of management exists when the parent company’s officers were providing general guidance and technical assistance. *Id.* In *Exxon Corp.*, 447 U.S. at 224, a unitary business exists where the integrated business benefited “from an umbrella of centralized management and controlled interaction.”

For centralization of management and control to exist, it must be present and occurring and not just legally permissible or the potential to exercise. *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 323 (1982 S.Ct.).

Economies of scale exist where there is a sharing of resources among members of the unitary group. *Container Corp.*, 463 U.S. at 178.

The second set of activities the Court has determined to be unitary is when related companies are vertically integrated. Vertical integration exists where profits are earned by a series of transactions between related corporations beginning with the manufacture in one location or company and ending with the sales transactions in different locations or related companies. *Bass, Ratcliff, & Gretton v. State Tax Commission*, 266 U.S. 271, 282 (1924 S.Ct.).

Third, the Supreme Court found a business to be unitary based on the single factor that there was a central buying division for the enterprises of the group which operated in different jurisdictions. *Butler Brothers v. McColgan, Franchise Tax Commissioner of California*, 315 U.S. 501, 508 (1942 S.Ct.).

In summary, once a taxing state has established nexus with a multistate business, it can tax an apportionable share of the multistate business’s income, if the multistate business is unitary. A unitary multistate business can be established by the factors of profitability, vertical integration, or having a shared management function benefiting enterprises operating in various jurisdictions. The unitary test as described here determines which entities may be subject to being taxed.

2.4.3.2. Analysis Determining [redacted] is Unitary with [redacted] and [redacted]

[redacted] is unitary with the [redacted] and [redacted] because they have a bond of ownership, they have the factors of profitability, they are vertically integrated, and because there was a centralized management function for the group that operated in several jurisdictions.

2.4.3.2.1. Ownership Bonds or Control

The Supreme Court stated that it requires "there be some bond of ownership or control uniting the purported 'unitary business.'" *Container Corp.*, 463 U.S. at 166. The ownership structure showing [redacted] and [redacted] ownership relationship is shown supra in the organization chart. This shows that [redacted] and [redacted] owned approximately 50% of [redacted] and [redacted]. It also shows that [redacted] and [redacted] owned approximately 77% of [redacted]. This shows [redacted] and [redacted] had enough of an ownership bond to be unitary.

In this case, [redacted] is a partnership and [redacted] is one of two equal, general partners. Based on the joint-venture agreement, only the partners have power to bind the partnership. Because the partners possess exclusive authority to bind [redacted] they have control sufficient to be unitary.

Also, both partners must agree on major operational terms, marketing plans, business plans, and budgets, and if they do not, the partnership reverts to a default operational mode until the dispute is resolved. Therefore, the dissenting partner has power to stop the other partner's conflicting decisions or objectives. Because each partner has power to stop the other, each partner possesses sufficient control to be found unitary.

2.4.3.2.2. Factors of Profitability

The factors of profitability exist because there is functional integration, centralized management, and there are economies of scale. Idaho Administrative Code section 35.01.01.341.02 refers to these factors as "significant flows of value."

Functional integration exists because [redacted] is the sole importer of [redacted] and merchandise, which is [redacted] primary product. [redacted] sells all its [redacted] to [redacted] which is used to [redacted] in [redacted] in Mexico of which a portion of [redacted] is imported by [redacted] provides carbon dioxide extraction for [redacted] products which are used in [redacted] which is imported by [redacted] owned by [redacted] exclusively licenses the [redacted] tradenames and trademarks to [redacted] for its use in the U.S. This network of related companies, each providing a different function to the common end of producing and selling [redacted] are functionally integrated. This is consistent to IDAPA section 35.01.01.342.01. (4-6-05) where it states that functional integration is present where there are "transfers between, or pooling among, business activities that significantly affect the operation of the business activities."

Centralization of management is present because (through its USA) provides quality control, sales and brand strategy, and distribution services on behalf of to (through its USA), provides the following services on behalf of to and accounting, IT, HR, customer service, and supply chain management. The transfer pricing report states that the services directly benefit

Additionally, four executives of are on the Board of Directors of and are actively involved in its management. The directors meet no less than quarterly and are the only ones who can bind them; they are required to approve Strategic Pricing Initiative, annual Business Plan, licensing and purchasing of brands, changes in capital structure, borrowings, asset dispositions exceeding \$250K, decisions to terminate officers of and appointing officers of. In the event of a voting deadlock on the Board, the CEOs of and are to resolve the difference, if possible, before litigation.

The involvement of the / USA employees who served as directors of and the participation of other employees on various committees substantiate that there was centralization of management. This comports with IDAPA section 35.01.01.342.02. (4-6-05) which states “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 are present because one-half of Board of Directors is comprised of executives which are compensated by. Therefore, is receiving the benefit of the director’s services at no cost. Additionally, (through USA) provides services on behalf of to and which directly benefit. This agrees with IDAPA section 35.01.01.342.03. (4-6-05) where it states “Economies of scale refers to the relation among and between business activities resulting in a significant decrease in ... administrative functions...”

In addition to services provided, there are significant transactions between the and showing economies of scale. The 5472s filed with the tax returns show that in 2010, the intercompany transactions totaled to over \$40 million, in 2011 over \$17 million, and in 2012 over \$21 million. These transactions are primarily from inventory sales, services, freight, and royalties. In addition to those transactions, was required to distribute its profits, monthly, to and

2.4.3.2.3. Vertical Integration

and are unitary with and because they are vertically integrated. and provide product to which uses in its imports and merchandise into the U.S. to be distributed and sold. a subsidiary of provides exclusive licensing to of trademarks and tradenames. Therefore, the production, importation, and marketing are present in the group.

2.4.3.2.4. Shared Management

and are unitary with and because they had a shared management group. In this case, the employees at (through USA) were shared by and these services were provided on behalf of and to the benefit of

2.4.3.2.5. Unitary Conclusion

The group exhibits the factors of profitability, it is vertically integrated, and there is shared management, therefore we uphold the Audit Bureau's taxing the U.S. group because the group is unitary. Even though the unitary group extends to the Mexican parent company, made a water's-edge election in 2007. Therefore, the Tax Commission can only tax the income of the unitary group members that operate in the U.S. and is precluded from asserting tax against world-wide income.

2.5. Sale of its Partnership Interest in is Business Income

2.5.1. Law Defining and Determining Business Income

After determining which entities are subject to tax from being a unitary business, one must determine the income that is subject to apportionment versus that which is allocable to a single situs. "Business income" is apportionable whereas "non-business income" is generally allocable to the taxpayer's state of domicile. IC § 63-3027(b) through (s) (2014).

Idaho Code section 63-3027(a)(1) (2014), defines business income as income arising from transactions and activity in the regular course of the taxpayer's trade or business. This is sometimes referred to as the transactional test. Next, business income includes income from the acquisition, disposition, or managing, of tangible and intangible property, so long as the acquisition, disposition, or management constitute an integral or necessary part of the taxpayer's trade or business. *Id.* This is referred to as the functional test. The Idaho Code presumes gains and losses, dividends, and interest income, from domestic or foreign stock or securities are business income unless the taxpayer can show otherwise by clear and convincing evidence. *Id.*

In defining "business income," the U.S. Supreme Court has stated that it is compatible with the unitary business principle. *Allied-Signal*, 504 U.S. at 786. More directly, the Idaho Supreme Court stated that "the unitary business test" falls under the Due Process Clause and Commerce Clause of the U.S. Constitution and the "business income" question in Idaho Code section 63-3027. *Noell Industries, Inc. v. Idaho Tax Commission*, 167 Idaho 367, 372 (2020). Therefore, showing a business is unitary is necessary to classify income as business income and to apportion income from members of a combined group.

IDAPA defines “business income” as income meeting the “transactional test” or the “functional test.” IDAPA § 35.01.01.331.01. (4-6-05). The transactional test includes “income arising from transactions and activity in the regular course of the taxpayer’s trade or business.” IDAPA § 35.01.01.332.01 (4-6-05). This would include frequently occurring transactions or transactions that are customary to the trade or business the taxpayer is conducting. IDAPA § 35.01.01.332.03. (4-6-05). However, the Regulation excludes income from investment activities that the taxpayer enters solely for financial betterment. *Id.*

The functional test includes income from tangible and intangible property, if the taxpayer’s acquisition, management, or disposition of the property is integral or a necessary part of the taxpayer’s regular trade or business operations. IDAPA § 35.01.01.333.01. (4-6-05). Integral or operative component of the taxpayer’s trade or business is property used in the taxpayer’s business operations or materially contributed to the production of business income. IDAPA § 35.01.01.333.03. (4-6-05). The transaction does not have to occur frequently to be business income. IDAPA § 35.014.01.332.03. (4-6-05). Under the functional test the transaction does not have to be a transaction that occurs in the regular course of business, it is only necessary that the property generating the income be integral, functional, or an operative component of the business operations or contribute materially to the production of business income. IDAPA § 35.01.01.333.03. (4-6-05).

The form of the business property (tangible, intangible, real, or personal property) is not relevant in applying the functional test. IDAPA § 35.01.01.333.08. (4-6-05). A property is presumed to be an integral part of the taxpayer’s business if the taxpayer takes a deduction or includes the property in their apportionment factor. IDAPA § 35.01.01.333.07. (4-6-05). If the taxpayer held the property to further their business beyond financial betterment, the income from the transaction creating the income from the property will be business income even though it did not occur in Idaho. IDAPA § 35.01.01.333.06. (4-6-05). Examples of business income under the functional test include infrequent dispositions, transfers, liquidation transactions, isolated sales, leases, assignments, and licenses if the property was used in the taxpayer’s trade or business. IDAPA § 35.01.01.333.04. (4-6-05).

2.5.2. Analysis Determining Business Income

The income from the sale of _____ partnership interest in _____ meets the functional test for two reasons: (1) _____ was part of a unitary business; (2) _____ was an integral and necessary part of that business. In the section above, “2.4.3. _____ Is a Member of a Unitary Business,” we determined that _____ is part of the unitary group of _____

It meets the functional test because the _____ partnership was an integral part of _____ business. It was integral because _____ was the sole importer of _____ and merchandise in the U.S. This activity consisted of \$2.7 billion in sales in 2012 to _____. It had the exclusive license of _____ trademarks and tradenames in the U.S. _____ provided supply chain, distribution, and marketing services to _____. The _____ sales, property, and payroll were included in the apportionment factors for _____. _____ was not a passive investor in _____ and the income from the sale of a business asset is business income. The fact that the sale of a partnership interest may occur infrequently or occurred outside Idaho is

irrelevant per IDAPA section 35.01.01.333.04 (4-06-05), because [redacted] did operate in Idaho and was a necessary or integral part of the business.

This is consistent with IDAPA section 35.01.01.333.07. (4-06-05) which presumes a property to be a necessary or integral part of the taxpayer's business if the taxpayer takes a deduction or includes the property in their apportionment factor. Since the [redacted] sales, property, and payroll factors were included in [redacted] apportionment factors, it meets the functional test. Additionally, it should be noted that since its inception, [redacted] treated income from [redacted] as business income under the transactional test because importing [redacted] and merchandise to sell is a regular transaction occurring in a [redacted] trade or business.

Holding that [redacted] gain from the sale of its partnership in [redacted] is apportionable/business income is consistent with the *Mobile* case, where the Court stated that when "a taxpayer's activities with respect to intangible property [e.g., a partnership interest or stock interest] involve more than one jurisdiction," "the reason for a single place of taxation no longer obtains." *Mobile*, 445 U.S. at 445.

We hold that [redacted] sale of its interest in [redacted] is business income because was an integral and necessary part of the [redacted] unitary business, consequently it meets the functional test.

3. The Correct Basis for Everywhere Property

[redacted] properly used historical cost in the denominator of its property apportionment factor. The Audit Bureau incorrectly used the taxpayer's financial statement basis of property assets for the denominator of the apportionment factor.

[redacted] prepares its financial statements using International Financial Reporting Standards ("IFRS"). The balance sheet amounts on the federal return reflect IFRS accounting standards. International Accounting Standard ("IAS") 36 Impairment of Assets requires companies to write down the value of assets to the amount that is recoverable through the asset's use or sale. Corresponding to the write down, the company must recognize a loss, these are often referred to as impairment losses. The Audit Bureau used the IFRS basis in computing the denominator in [redacted] apportionment factor.

Neither the Internal Revenue Code nor Idaho Code section 63-3027(1) (2014) realize impairment write-downs in asset values and the corresponding losses. Idaho Code section 63-3027(1) (2014) requires the use of historical cost in computing its apportionment factors. In this case, the taxpayer incurred an impairment loss on its fixed assets and wrote down their value to comply with IAS 36. Accordingly, we find for the taxpayer that historical cost is the correct value in determining its apportionment factors. This holding is reflected in the revised tax computations contained in Attachment A.

4. Idaho Sales

We uphold the Audit Bureau's adjustment to the sales factor. The Audit Bureau included in the numerator of the sales factor the sales of [redacted] to its Mexican parent [redacted] and its affiliates. [redacted] product is used in the [redacted] of [redacted] Idaho Code section 63-3027(q)(2) (2014) requires taxpayers to include in their Idaho sales, sales of product they ship from Idaho to locations outside of Idaho to the extent the taxpayer is not taxed in the destination location. The taxpayer excluded the sales of [redacted] to [redacted] (or affiliates) which were shipped to Mexico.

The taxpayer argues that such sales should be excluded from the sales factor because [redacted] is part of a unitary group under [redacted] which included [redacted]. The taxpayer argued that [redacted] has [redacted] and [redacted] (materials used in shipping of [redacted] in Mexico giving it permanent establishment (permanent establishment is akin to nexus). The taxpayer contends that [redacted] permanent establishment makes the [redacted] unitary group file a tax return in Mexico and pay tax on the sales for [redacted]. The taxpayer has acknowledged that this argument is contrary to the argument noted above stating that [redacted] is not part of a unitary group and argues that if [redacted] is determined to be unitary, the [redacted] sales should be excluded from the sales factor.

We hold the Audit Bureau's position is correct because the taxpayer has not shown that the sales are taxable in Mexico. [redacted] did not provide a copy of a [redacted] tax return filed in Mexico where [redacted] paid tax on [redacted] sales. Contrary to the taxpayer's assertion that [redacted] and [redacted] create a filing requirement for [redacted] the tax treaty between the U.S. and Mexico, specifically exclude from creating permanent establishment in Mexico and creating a filing obligation, the following activities:

- maintaining of a stock of goods used for storage,
- display,
- delivery (in this case [redacted] and [redacted] which is shipping and storage material for the [redacted] industry),
- or the holding of goods or merchandise solely for the processing by another enterprise. See United States – Mexico Income Tax Convention, U.S.-Mexico, Entered into Force December 28, 1993, Article 5 paragraphs 4(b) and (c), www.irs.gov/pub/irs-trty/mexico.pdf.

Therefore, we hold that the [redacted] sales to Mexico are properly included in the Idaho sales factor.

5. Idaho Investment Tax Credit

The Audit Bureau disallowed a portion of Idaho Investment Tax Credit in the amount of \$3,260 for 2013, \$24,952 for 2014, and \$14,438 for 2015. We uphold the Audit Bureau in part and uphold the taxpayer in part.

Idaho Code section 63-3029B (3) defines a qualified investment as that which qualifies under IRC sections 46(c) and 48 as existed in the 1986 Internal Revenue Code prior to November 5, 1990. IC § 63-3029B (11) (2015). The law allows a credit for investments in tangible personal property, excluding heating and air conditioning, and excluding building and its structural components. IRC section 48(a)(1)(A) and (B) (1989). The taxpayer claims its facility qualifies as tangible personal property claiming the property is used as an integral part of manufacturing, production, or bulk storage of fungible commodities. IRC § 48(a)(1)(B)(i) and (iii) (1989). The taxpayer relies on Technical Advice Memorandum 8018013 and *Brown Forman Distillers Corp. v. Unites States*, 499 F.2d 1263, 205 CT. Cl. 402 (1974).

In TAM 8018013, the IRS performed the observation and function test. The building met the observation test for being a building because it had walls and a roof therefore appeared to be a building. However, the structure did not meet the function test which is that a building is to provide “shelter or housing, or providing work, office, parking, display or sales space.” *Id.* Since it did not meet the function test, it was treated as a piece of equipment because it was devoted almost entirely to the processes and had no restrooms, locker rooms, or lunchroom facilities. It should be noted that there was a single office located by a utility bay and a maintenance storage room, but the overall purpose of the building was to operate as a piece of equipment and not provide working space, parking, or sales space for employees.

In *Brown Forman Distillers*, the Court noted the facilities operated as ovens, contained no working space, and that the facilities are retired along with the other equipment.

In this case, the Audit Bureau requested a tour of the facility, and the taxpayer declined their request. It could not observe if there were any restrooms, lunchrooms, offices, or things that were beyond the process that would qualify under the function test as providing a workspace or housing employees. Consequently, the Audit Bureau made their determination based on the descriptions on the asset schedule. The Audit Bureau correctly disallowed monies spent in 2013, 2014, and 2015 which constitute driveways, pedestrian walkways and signage, and a septic tank pipe because these items are real estate improvements and are not integral to the manufacturing. Also, these items meet the function test to qualify as a building. The amounts spent on engineering plans are not allowed because the Audit Bureau does not know if the plans related to qualifying property or were essential to the process. The doors, roofing, underground pipes, conduit, light fixtures, pumps, boilers, elevator and headhouse are structural components of the building and do not qualify for the credit. The amount we allow as qualifying for the credit is the amount described as “Light Fixture – because it appears to be integral to the process. This adjustment is reflected in the Attachment A.

6. Penalty

We uphold the Audit Bureau’s assertion of the penalty under Idaho Code section 63-3046(a) (2002) due to “negligence or disregard of the rules” and Idaho Code section 63-3046(d) (2002) for substantial understatement. We uphold the penalties for the following reasons:

- The taxpayer’s position on “Business Income” is contradictory to the facts and their previous tax filings and elections to the State.

- Taking investment tax credit on parking lots, pedestrian walkways and signage, painting crosswalks and sidewalks, and other assets which are not qualifying property.
- Excluding sales which are properly includable in Idaho sales.

7. Conclusion

The Tax Commission concludes the following:

- We uphold the Audit Bureau's determination that the gain from _____ sale of its partnership interest in _____ is business income subject to apportionment.
- We hold for the taxpayer that historical cost should be the correct value for the assets used in the denominator of its apportionment factor.
- We hold the Audit Bureaus' determination that the sales made to an affiliate in Mexico are subject to throw back to Idaho and included in numerator of the Idaho sales factor.
- We uphold the Audit Bureau's determination in part and find for the taxpayer in part. The assets which appear to qualify as equipment are allowed for purposes of computing the Idaho Investment Tax Credit. The assets which appear to be real property do not qualify for Idaho Investment Tax Credit.
- We uphold the Audit Bureau's penalty determination for negligence and substantial understatement.

An explanation of Petitioner's right to appeal this decision is enclosed.

DATED this _____ day of _____ 2022.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2022,
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:

Receipt No.
