

Petitioner protested the Notice, disagreeing with the Bureau's adjustment to nonbusiness income for the short period that ended July 25, 2022.² Petitioner argued in the protest that the settlement proceeds from the lawsuit was nonbusiness income as it did not meet either the transactional test or the functional test. The Bureau acknowledged Petitioner's protest and sent the matter to the Tax Commission's Appeals Unit (Appeals) for administrative review.

Appeals reviewed the case and sent Petitioner a letter explaining the options available for redetermining a Notice. Petitioner responded but did not request an informal hearing nor did they provide additional information. The Tax Commission, having reviewed the file, hereby issues its final decision.

LAW AND ANALYSIS

Business income

Idaho Code section 63-3027(a)(1) provides two separate definitions, transactional test and functional test, for "business income":

"Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitutes integral or necessary parts of the taxpayer's trade or business operations. Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitutes an integral part of the taxpayer's trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary.

² The Bureau adjusted Petitioner's apportionable income, not just for nonbusiness income for the short period ending July 25, 2022, but also for other subtractions and foreign dividend exclusion for tax year 2021. Since Petitioner did not protest the Bureau's adjustments for 2021, the Tax Commission will not address them.

Transactional test

The transactional test provides that business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business."³ However, Idaho Income Tax Administrative Rule IDAPA 35.01.01.332.03., states in part that the transaction or activity "need not be one that frequently occurs in the trade or business." It is reasonable to conclude that transactions are made "in the regular course of a trade or business" where they "are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does."⁴ In addition, "Income may be business income even though the actual transaction or activity that gives rise to the income does not occur in Idaho."⁵

Functional test

The functional test provides that business income is "income for the acquisition, management, or disposition of tangible property when such acquisition, management or disposition constitute integral or necessary parts of the taxpayer's trade or business operations." The functional test consists of two tests: operational or passive investment test, and unitary business test, and to meet the functional test, both tests must be applied as the Idaho Supreme Court explained in the *Noell* case⁶,

Rule 333.08 of Idaho's Income Tax Administrative Rules provides two methods for meeting the functional test: "business income" can be established either by (a) finding that the intangible interest serves an operational function-rather than a passive investment-as "an integral, functional, or operative component to the taxpayer's trade or business operations," or (b) by meeting the unitary-business test. IDAPA 35.01.01.333.08. Even though these methods would appear to be independent of each other, the U.S. Supreme Court has rejected the notion that the operational-function test and unitary-business test are separate principles.

³ Idaho Code section 63-3027(a)(1).

⁴ IDAPA 35.01.01.332.03.

⁵ IDAPA 35.01.01.332.02.

⁶ *Noell Industries, Inc. v. Idaho State Tax Commission*, 167 Idaho 367, 470 P3d 1176 (2020).

MeadWestvaco Corp. ex rel. Mead Corp. v. Illinois Dep 't of Rev., 553 U.S. 16, 29-32 (2008). Therefore, **we must apply both tests.**⁷ (emphasis added)

Operational or passive investment test

IDAPA 35.01.01.333.05., provides,

Under the functional test, income from intangible property is business income when the intangible property serves an operational function as opposed to solely an investment function. The relevant inquiry focuses on whether the property is or was held in furtherance of the taxpayer's trade or business, that is, on the objective characteristics of the intangible property's use or acquisition and its relation to the taxpayer and the taxpayer's activities. The functional test is not satisfied where the holding of the property is limited to solely an investment function as is the case where the holding of the property is limited to mere financial betterment of the taxpayer in general.

Unitary business test

Idaho Code section 63-3027(t) states in part,

...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... apportioned as if the group of corporations were a single corporation, in which event:

IDAPA 35.01.01.340 through 344, outlines the principles for determining the existence of a unitary group. IDAPA 35.01.01.340 explains the concept of a unitary business as a "single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities..." and IDAPA 35.01.01.341.02., further explains,

A unitary business is characterized by significant flows of value evidenced by factors such as those described in *Mobil Oil Corp. v. Vermont*, 445 U.S. 425 (1980): functional integration, centralization of management, and economies of scale. These factors provide evidence of whether the business activities operate as an integrated whole or exhibit substantial mutual interdependence. Facts suggesting the presence of the factors mentioned above should be analyzed in combination for

⁷ The functional test consists of (a) operational or passive investment test, and (b) unitary business test.

their cumulative effect and not in isolation. A particular business operation may be suggestive of one (1) or more of the factors mentioned above.

In the present case, Petitioner received the settlement proceeds in 2022 because of the lawsuit filed by [REDACTED] shareholders. The 2018 merger created [REDACTED] [REDACTED] [REDACTED] [REDACTED] (Petitioner), and [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED],⁸ who owned the majority shares in both [REDACTED] and [REDACTED] became the controlling shareholder of Petitioner. [REDACTED] shareholders alleged that [REDACTED] forced [REDACTED] into an unfair and conflict-laden merger⁹ and manipulated [REDACTED] [REDACTED] stock value as [REDACTED] owned significant stakes in both [REDACTED] and [REDACTED].¹⁰ In 2022, the Court approved a \$100 million cash settlement to the shareholders, and [REDACTED] and the directors of [REDACTED] paid \$76.5 million (\$100 million cash settlement, minus \$23.5 million of legal fees) to Petitioner. Since the lawsuit was classified as a derivative suit,¹¹ the settlement proceeds were paid to Petitioner. A few months after the completion of the settlement, [REDACTED] acquired the remaining shares from [REDACTED] shareholders, and Petitioner became a privately held company.¹²

Appeals reviewed Petitioner's federal return and found that they reported the settlement proceeds as part of "other income",¹³ which indicates that it is taxable but did not come from their core business operations. The tax implication of the proceeds is based on the "origin of the claim"¹⁴ that resulted in the settlement. As explained in the protest, the activity that generated the settlement proceeds in 2022 was the lawsuit filed by the [REDACTED] shareholders in 2018. Although the claim

⁸ [REDACTED] [REDACTED] [REDACTED] is a private equity firm.

⁹ [REDACTED] failed to disclose conflicts in interest in regulatory filings related to the merger.

¹⁰ [REDACTED] owned [REDACTED] at 34% and [REDACTED] [REDACTED] approximately at 70%.

¹¹ Generally, a derivative suit is a type of lawsuit brought by a shareholder on behalf of a corporation against its own directors, officers, or other parties who have harmed the company. The claim belongs to the corporation, not the individual shareholder, so any recovery goes back to the corporation itself.

¹² Petitioner stopped trading on the New York Stock Exchange in [REDACTED].

¹³ Federal Form 1120, line 10. Other income.

¹⁴ The origin of claim is a legal doctrine, and the test determines the nature of income/expense by examining the transaction or activity from which the claim originated. It focuses on the facts of the matter and the basis of the claim, not the potential outcome or the taxpayer's motivation.

belonged to Petitioner, they did not initiate the lawsuit nor did they have control over the subject matter of the litigation. Rather, in this instance, the control of the litigation rested with the shareholders who initiated the lawsuit while Petitioner was only bound by the results of the adjudication. The settlement proceeds were not derived from Petitioner’s regular course of business nor was it an integral component of their business operations. Therefore, the Tax Commission found that the settlement proceeds did not meet the transactional test or the functional test.

CONCLUSION

The Tax Commission determines that the settlement proceeds Petitioner received was nonbusiness income. Therefore, the Tax Commission modifies the Notice to accept Petitioner’s treatment of the settlement proceeds as nonbusiness income. The Bureau added interest and penalties to Petitioner’s Idaho tax. The Tax Commission reviewed the additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

THEREFORE, the Tax Commission AFFIRMS the Notice, dated July 22, 2025, and directed to Petitioner, as MODIFIED by this decision.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/2021	\$65,006	\$9,751	\$7,355	\$82,112
7/22/2022	(5,457)	0	(627)	(6,084)
			TOTAL DUE	<u>\$76,028</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

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

DATED this _____ day of _____ 2025.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2025,
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.


