

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of Protest of

CASE NO. 1-218-484-224

DECISION

Petitioner

1. Summary

timely filed a protest (“Protest”) and petition for redetermination of the Notice of Deficiency Determination (“Notice”) dated July 30, 2020 for the tax period ending December 6, 2016. The Idaho State Tax Commission reviewed the case and now renders its final decision on the contested issues. The contested issues are whether the gain from the sale of the joint-venture/partnership interest in is business income and the negligence and substantial understatement penalty. The Tax Commission upholds the Notice and requires full payment of tax in the amount of \$2,412,587, penalty of \$361,888, plus interest of \$516,425 (computed through March 15, 2023).

2. Background

2.1. Joint Venture

In 2007, plc, a multinational company headquartered in England, and a company headquartered in Illinois, decided to combine their operations in the United States by creating a joint venture. The joint venture was called and was organized under the laws of Delaware as a limited liability company. This joint venture was treated as a partnership for tax purposes. The purpose of the joint venture was to strengthen their brands and combine their resources for production and distribution to better compete in the marketplace

against their primary competitor
reduce costs and create economies in

- This joint venture would also
operations.

The joint venture was approved by federal antitrust regulators in June of 2008 and on July 1, 2008, the companies entered into the Amended and Restated Operating Agreement (“Operating Agreement”). Each partner contributed assets to the joint venture and received an ownership interest in proportion to the assets it contributed. However, each partner received an equal voting interest. The ownership structure is as follows:

Owner	Class A Shares	Class B Shares	Total Ownership	Voting Percentage	Profit/Loss and Distribution Percentage
	420,000	160,000	580,000	50%	58%
	420,000		420,000	50%	42%
Total	840,000	160,000	1,000,000	100%	100%

In this case, the owners received monthly cash distributions and profit and loss allocations in respect to their ownership percentage of 58% to and 42% to

However, the Class B shares held by were non-voting shares which means that each owner had equal voting rights.

Along with the Operating Agreement, entered into the following agreements:

- Services Agreement with
- Contract Brewing Agreement with and
- Brand Co-operation Agreement with and

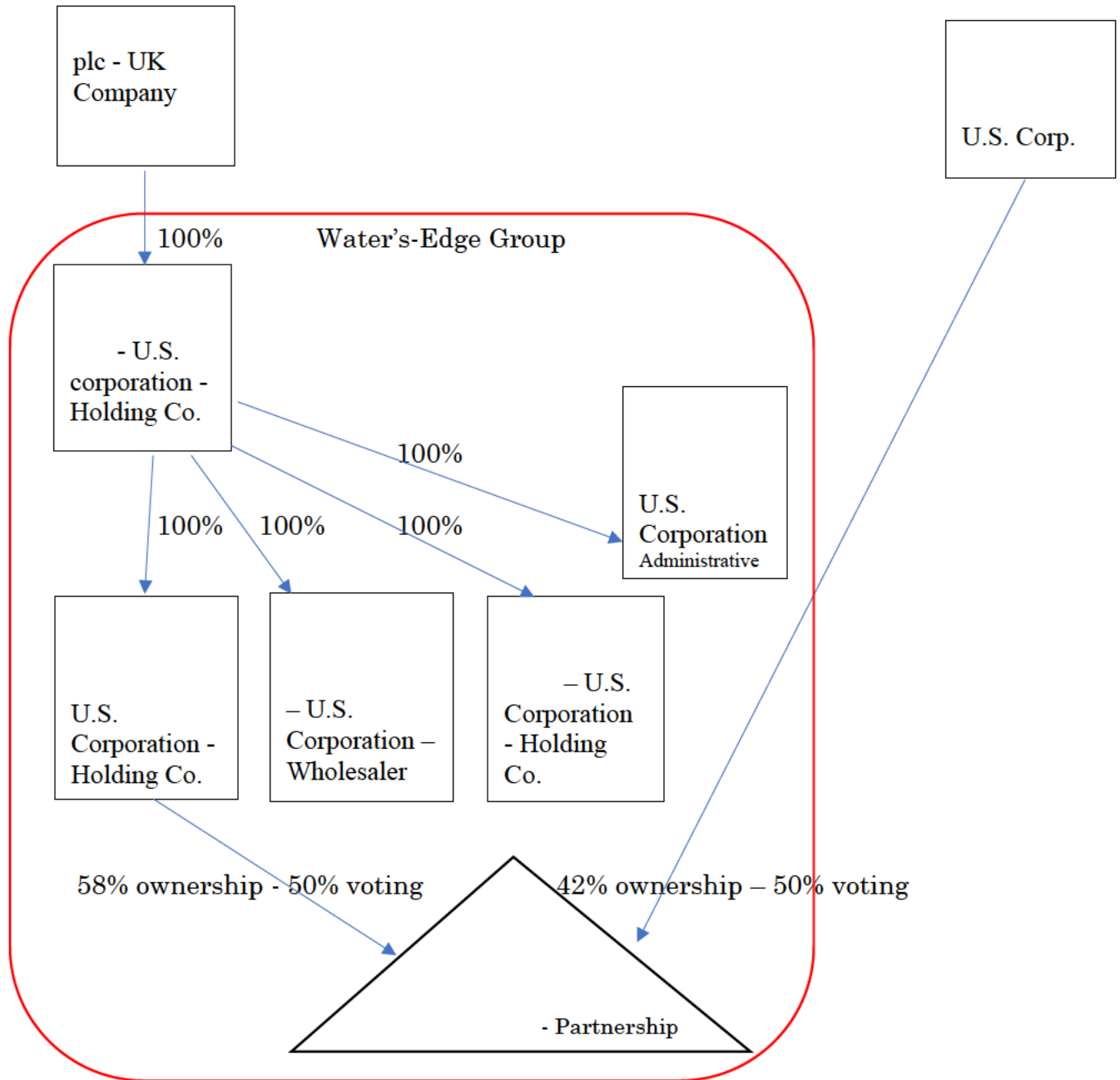
The Department of Justice (“DOJ”) described the joint venture as follows:

is the second largest company in the United States, accounting for 25% of sales nationally. operates 12 in the United States and has the sole right to produce and sell in the United States more than 40 brands of including and the -highest selling brands in the United States. has the right to produce and sell in the United States other popular brands of such as and Additionally, has the exclusive right to import into and sell in the United States certain beer brands owned by including and

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2.2. Organization Chart.

Prior to [redacted] acquisition in 2016 and based on the information provided by the taxpayer, the [redacted] and [redacted] ownership structure was as follows:



2.3. Company Descriptions

The taxpayer describes _____ as a pure holding company and _____ as a company which employed approximately twenty-five people who provided oversight services to Canada and South American countries. The taxpayer described the oversight services as follows: introducing brands in Canada and South American countries, tax compliance, and financial reporting and compliance for _____ and its subsidiaries.

The taxpayer shows the wholly owned subsidiary _____ as a wholesaler, _____ as a holding company, and _____ as an administrative entity.

The Department of Justice Antitrust Division described _____ as the second-largest _____ in the United States accounting for approximately twenty-five percent of _____ sales nationally. It operated twelve _____ and possessed the exclusive right to produce and sell forty brands of _____ in the United States. _____ also had the exclusive right to import and sell in the United States certain brands owned by _____. Through _____ conducts substantially all its operations in the United States, retains certain _____ assets, and conducts business outside of the United States..

2.4. Filing History

Before the acquisition by _____ - _____ in 2016, _____ filed income tax returns showing the flow-through income from _____ as business income since its initial filing. _____ also filed a water's-edge election in Idaho in 2009 and subsequent years. The water's-edge combined group consisted of the following corporations:

These corporations are shown in the diagram in section 2.2. "Organization Chart" of this decision.

_____ reflected income from _____ as apportionable/business income since its inception in 2008. When _____ - _____ purchased _____ in 2016, it took the position that income from the sale of its ownership interest in _____ was non-business income.

2.5. - Acquisition of and the Sale of

On November 11, 2015, - / agreed to acquire for \$107 billion. The United States filed a civil antitrust Complaint against - and to stop the transaction. In order for - to complete its purchase of the U.S. Department of Justice Antitrust Division required - to sell or have sell its interest in to (or another non-related party). - announced that it had completed its sale of to on October 11, 2016. After - acquired it changed the name of to -

3. Business Income versus Non-Business Income

3.1. Issue

The primary issue in this case is whether the gain from the sale of the joint-venture/partnership interest in is business income. In making this determination we determine if was part of a unitary business which was conducted in Idaho. If it was, the income from sale of its joint-venture interest in is apportionable business income.

3.2. Taxpayer's Position

The taxpayer argues that was not unitary with therefore, Idaho cannot apportion gain from the sale of to Idaho. The taxpayer argues they are not unitary because the factors of profitability were not present between and The factors of profitability consist of centralization of management, functional integration, and economies of scale.

Also imbedded in their argument is the partnership "entity theory." This theory states that the partnership is a separate entity from the partner and the ownership interest is an autonomous asset. They argue that they are not in the trade or business of selling partnerships, therefore the sale of is not business income. They also argue that the gain from the sale of the partnership interest does not meet the "functional test" because there was no unitary relationship between and and therefore the gain is not apportionable to Idaho.

**3.3. Tax Commission’s Summary Conclusion that
Unitary with the
Edge Group**

**is
Water’s-**

We uphold the Audit Bureau’s determination that had a unitary relationship with and the gain from sale of its joint-venture interest in produced business income which is apportionable to Idaho. We find that centralization of management and control, economies of scale, and functional integration were present and substantiate the unitary relationship between and and the combined water’s-edge group.

3.4. Law

**3.4.1. Constitutional Provision 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 436-37 (1980). Stated differently, the test is whether the state has given anything for which it can ask a return. *State of Wisconsin v. J.C. Penny*, 311 U.S. 435 at 444 (1940). The test is met, or the connection exists, if the corporation carries on business within the State. *Mobile Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 at 438; *State of Wisconsin v. J.C. Penny Co.*, 311 U.S. 435 at 444-45. In this case, has availed itself of carrying on business in Idaho because the activity of produces sales, has property, and payroll in Idaho. Because is a partnership, its sales, property, and payroll factors flow through to the partners. IDAPA § 35.01.01.620.

3.4.2. Unitary Principle

The Supreme Court stated the concept behind the unitary principal is that a state,

[M]ay look to the property of such corporations beyond its borders to ‘get the true value of the things within it, when they are part of an organic system of wide extent,’ giving the local property a value above that which it would otherwise possess, and may therefore take into account property situated elsewhere when it ‘can be seen in some plain and fairly intelligible way that it adds to the value of the [property] and the rights

exercised in the State.’ This is directly applicable to the carrying on of a unitary business of manufacture and sale partly within and partly without the State. *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271, 282 (1924).

A unitary business is a vertically integrated business where the various components (manufacturing, sales, etc.) are operated in different states. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). A international vertically integrated business is also unitary. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924). A unitary business also exists where similar enterprises operating in different states share common managerial or operational resources that produce economies of scale and value transfers. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *Butler Bros. v. McColgan*, 315 U.S. 501, 506-10 (1942). Additionally, a unitary business exists where there the factors of profitability are present. *Mobile Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438 (1980). The factors of profitability consist of functional integration, centralization of management, and economies of scale. *Mobile Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438. In Idaho, the factors of profitability are defined as follows:

- Functional integration exists where there is a transfer between or pooling among business activities that significantly affect the business operations. For example, transfers of products, services, information, use of intangibles (e.g. patents, trademarks, formulas, trade secrets), and processes. IDAPA § 35.01.01.342.01.
- Centralization of management exists when directors, officers, or other management employees jointly participate in management decisions of the business or that may also benefit the entire economic enterprise. IDAPA § 35.01.01.342.02.
- Economies of scale exist where there is a relationship among the business activities that results in a decrease of costs. An example would be when there is a centralized purchasing or administrative function which serve several entities of a group. IDAPA § 35.01.01.342.03.

In conjunction to finding a business is unitary, the State must show the following four factors:

- First, a minimal connection between the intrastate activities and the taxing State. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 165-66.
- Second, a rational relationship between the income attributed to the State and the intrastate values of the enterprise. *Id.* at 166.

These first two bullets can be summarized in the principle that some part of the unitary business is conducted within the taxing State's borders. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *Exxon Corp.*, 447 U.S. 207 at 220 and *Wisconsin v. J.C. Penny Co.*, 311 U.S. 435 at 444.

- Third, there is a bond of ownership or control **uniting** the unitary business. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *ASARCO*, 458 U.S. 307, at 316. *ASARCO* refers to *Mobile* where the Court noted that in *Mobile* the business was conducted through wholly or partially owned subsidiaries and that there was no evidence that its subsidiaries and affiliates are discrete businesses and do not contribute to *Mobile*'s worldwide income. In *Mobile*, the Court stated "Our inquiry is confined to the questions whether there is something about the character of income earned from investments in affiliated and subsidiaries operating abroad that precludes, as a constitutional matter, state taxation that income by the apportionment method." *Mobile*, 445 U.S. 425, 434-35. After reviewing the references in *ASARCO* and *Mobile*, the ownership or control the Court in *Container Corp.* is referring to is the element that unites the companies in the unitary relationship such as being a subsidiary or affiliate. It should be noted that the Court did not specify a required ownership percentage to be unitary.
- Fourth, the out of state activities of the unitary business must be related "in some concrete way" to the in-state activities. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166. "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 distinct business operation-which renders formula apportionment a reasonable method of taxation." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 at 166 citing *ASARCO*, 458 U.S. at 327-28; *Mobile Oil Corp.*, 445 U.S. at 438-442.

3.4.2.1. Aggregate and Entity Theory Versus Enterprise Unity and Asset Unity

The aggregate theory is the partnership is a conduit and the partner owns all the assets and liabilities of the partnership. In other words, the partner and the partnership are one in the same. The partnership pays no tax and the partner pays all the tax on their share of the partnership income, deductions, credits, and other tax attributes generated at the partnership level. See *Study Outline For: Partnership Taxation Overview of Entities*, www.taxtaxtax.com/pship/study.lect1-5366.htm, accessed on 1/9/2023.

The entity theory is the partnership is a distinct entity from the partner, similar to a corporation and its shareholders. The partnership has its own tax elections, tax year, and accounting methods. *Id.*

Basing their approach on the entity theory, the taxpayer argues that the partnership ownership interest (an intangible asset) is situated outside of Idaho where the owner, _____ is domiciled. They further argue that the value of the partnership interest is generated at the partner level, which occurs outside of Idaho and therefore cannot be taxed by Idaho. This argument is based on the premise that the partnership is distinct from the partner and therefore the partner's ownership interest is a distinct asset from the partner. The U.S. Supreme Court negated this argument when they held that when it comes to income tax, the situs or commercial domicile for intangible property "no longer obtains' when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction." *Mobile Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 at 445 (1980). In other words, income from an intangible is taxable based on where it is used, not where its ownership resides. Therefore, if the intangible asset is used in multiple jurisdictions, the income from it is apportionable to those jurisdictions.

Consistent with this Supreme Court decision, we believe the correct analysis to apply is enterprise unity and asset unity. With enterprise unity, if the business is part of a unitary business, the income from its operations, distributions, or from the sale of a division, is apportionable. Vol. 1, Jerome R. Hellerstein & Walter Hellerstein, *State Taxation*, Third Edition, ¶ 8.07[2][a] (August 2022). With asset unity, if the asset is an integral part of the unitary business, the gain from its sale is apportionable. *Id.*

Enterprise unity exists where related businesses are vertically integrated, where there is a sharing of management and/or operational resources, or the factors of profitability exist between related businesses (see 3.4.2. Unitary Principle supra). In enterprise unity, the payor and payee of income are generally part of the same

unitary group. See J. Hellerstein & W. Hellerstein, *State Taxation* ¶ 8.08[2][f][ii] Warren Gorham & Lamont 3rd Edition (August 2022).

Asset unity exists where the asset serves an operational function in a unitary business. *MeadWestvaco Corp. v. Illinois Department of Revenue*, 553 U.S. 16 at 28 (2008). What is required “is that the capital transaction serve an operational rather than an investment function.” *Allied Signal, Inc. v. Director of Taxation*, 504 U.S. 768, 787 (1992). It is not necessary that the payor of income be unitary with the payee. *Id.* at 787; see also J. Hellerstein & W. Hellerstein, *State Taxation* ¶ 8.08[2][f][iii] Warren Gorham & Lamont 3rd Edition (August 2022). An example of this is interest income on a bank account where the deposited funds come from working capital accounts. *MeadWestvaco Corp. v. Illinois Department of Revenue*, 553 U.S. 16 at 29 (2008). A second example would be income from futures contracts the taxpayer used to hedge the cost of goods the taxpayer intends to purchase in the future in furtherance of its business. *Id.* In both these examples, the payor was not a unitary member of the business but the transaction generating the income was from an operational asset or operational transaction. Because the asset or transaction served an operational function in a unitary business that was conducted in the taxing state, the State had claim on a portion of the income. *Id.* at 29-30. While the U.S. Supreme Court was not specifically addressing partnerships, it held that if the asset in question is a business, the correct way to determine if it was used in a unitary business is if the business being sold and the selling business had functional integration, centralized management, and economies of scale. *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16 at 30 (2008).

As noted above in Section 3.4. “Unitary Principle,” the U.S. Supreme Court has used other tests to prove a unitary business relationship in addition to the factors of profitability as listed in *MeadWestvaco Corp.*

3.5. Facts and Analysis Showing [redacted] is Part of a Unitary Business with [redacted] Operating in Idaho.

The relationships between the members of the water’s-edge combined group show that [redacted] was a unitary member of the group. The unitary relationship is shown in the intercompany agreements and its filing history.

3.5.1. [redacted] and [redacted] Conducted Business in Idaho

The apportionment schedules of [redacted] showed it had property, payroll, and sales in Idaho. See 3.4.1. “Constitutional Provision showing Idaho is Properly Asserting its Jurisdiction to Tax a Unitary Business.

3.5.2. Common Bonds of Ownership or Control Exist Between and the Unitary Group

owned one hundred percent of the subsidiaries in the unitary group. through had a 58% economic interest (profits, losses, capital contributions and distributions) and a 50% voting interest in resulting in being the majority owner with equal governance rights with the other partner. This is shown in the diagram in section 2.2. "Organization Chart." This shows common ownership and control for purposes of establishing a unitary relationship of the water's-edge group.

exercises control over per the Operating Agreement (discussed below in Section 3.5.4.1.) as follows:

- All authority to act is vested in the Board of Directors which are appointed by the owners. Section 5.1.
- The owners get to appoint equal number of directors. Section 5.3.
- The directors are solely accountable to the owners who appointed them Sections 5.4(a)-(e) and 11.1(a)-(b).
- A majority vote is required to approve a measure. Section 5.5(e).
- However, only two directors are required make a quorum or approve a vote as compared to three which the agreement requires for directors. This makes it easier for to get to quorum or approve a measure. Sections 5.5.(d)-(e).
- The Board will appoint the following committees: Audit, Compensation, Ethics and Compliance and Corporate Responsibility. Section 6.
- The officers act under the delegation of authority from the Board. Sections 7.1, 8.1, 8.2,
- company officers are not entitled to vote. Section 5.5.(f).
- will appoint the first Chairman of the Board who will be Mr. and is required to appoint him to a second term. Section 5.6.(d). After the initial term, successive Chairmen are appointed by alternating partners but in no event is the same partner permitted to choose the Chairman and Vice Chairman. *Id.*
- The first Vice Chairman is the CEO of and is required to appoint him to a second term. Section 5.7.(d). After the initial term, successive Vice Chairmen are appointed by alternating partners but in no event is the same partner permitted to choose the Chairman and Vice Chairman. *Id.*
- The officers are responsible to the Board. Section 7.1.
- can request the resignation of the CEO after two years and does not get this option. Section 7.2(d).

- If the Board does not find a successor candidate for CEO within [redacted] can nominate 2 successor candidates whereas [redacted] can only nominate one. Section 7.2(d) and (e).
- [redacted] directors can remove the CIO after consulting with the other [redacted] directors. [redacted] directors do not have this option. Section 8.5.

These terms show that control rests with the Board of Directors which are only accountable to the owners, [redacted] and [redacted]. The [redacted] officers are accountable only to the Board and act under their delegation of authority. [redacted] has a more favorable position because it takes less directors to get to a quorum and pass measures. The [redacted] directors get to nominate more candidates for CEO than the [redacted] directors and can remove the CIO whereas the [redacted] directors cannot.

It should be noted that the DOJ stated in their Competitive Impact Statement that “As a majority owner with equal governance rights over [redacted] [redacted] would be able to direct the competitive behavior of [redacted] leading to a loss of competition between the firms both nationally and in every local market in the United States.” This statement shows that a majority ownership with equal governance rights can direct the behavior of [redacted].

COMPETITIVE IMPACT STATEMENT at 7, *United States of America Department of Justice v. [redacted]* - [redacted] and [redacted] / /

Likewise, the United States Court of Appeals, Sixth Circuit determined that [redacted] and [redacted] exercise control over [redacted] based on [redacted]

Their equal voting power, veto power, the appointment of directors, all of whom are present officers or employees of the joint venture partners, and who owe their fiduciary duty only to [redacted] or [redacted] their influence over the executive team, and their funding of [redacted] the evidence shows that [redacted] and [redacted] together retain the power to ‘direct, superintend, restrict, govern, [and] oversee’ [redacted] ([redacted]

This shows that the partners exercise control over [redacted] and were actively operating and controlling the business. Therefore, the partnership is unitary and not a discrete business or passive investment.

3.5.3. Relationship Between Out-of-State Activities to Idaho Activities

operated in Idaho as shown by having property, payroll, and sales in Idaho which flows through to the partner appurtenant to IDAPA § 35.01.01.620. This was discussed in 3.4.1. “Constitution Provision showing Idaho is Properly Asserting its Jurisdiction to Tax a Unitary Business.” Having property, payroll, and sales in Idaho establishes the necessary link between the business conducted in Idaho and the gain on the sale of that business. Stated differently, because part of the value of the partnership interest resulted from the business activity in Idaho, Idaho has given value for which it can ask a return.

3.5.4. The Intercompany Contracts Show was Operating as a Member of a Unitary Group

The following agreements involving and show centralization of management and control, economies of scale, and functional integration:

- Amended and Restated Operating Agreement dated July 1, 2008 (“Operating Agreement”) - this is the joint venture operating agreement involving the following four parties:
 - and
- Services Agreement with dated July 1, 2008 (“Services Agreement”) – this is an agreement between (recipient of services) and (provider of services).
- Brewing Agreement with and dated July 1, 2008 (“Brewing Agreement”). This contract provides a that will order, purchase, and pay for product that manufactures. Product includes all brands. also agrees to provide administrative services to
- Brand Co-operation Agreement with and dated July 1, 2008 (“Brand Co-operation Agreement”). This an agreement provides to royalty and supply agreements between and the other parties.

3.5.4.1. Amended and Restated Operating Agreement

The Operating Agreement provides the following terms showing the relationship between the joint venture and its partners.

3.5.4.1.1. Board of Directors

All the power of the Company is vested in the Board of Directors (“Board”) and the Board is the manager of the Company. Operating Agreement section 5.1. The power to vote is vested in the Board with each director having a single vote. *Id.* at section 5.5(e). Each shareholder gets to appoint five directors. *Id.* at section 5.3. It should be noted that the officers (CEO, CFO, CIO, and CCO) of do not get to vote on any matter before the Board. *Id.* at section 5.5(f).

The Operating Agreement requires two directors appointed by and three directors appointed by to form a quorum. *Id.* at section 5.5.(d). This term makes it easier for the directors to get to quorum. Directors can only be removed by the shareholder who appointed them. *Id.* at section 5.4.(c). The Directors have no duty to the Company, only to the shareholder who appointed them. *Id.* at section 11.1. and 5.4(c).

There are a minimum of six Board meetings per year. *Id.* at section 5.5.(a). A majority vote is required to approve any measure and the approval must consist of two directors and three directors’ approvals. *Id.* at section 5.5.(e). This term makes it easier for directors to pass measures because it requires fewer directors’ approval or vote.

The Operating Agreement provides that Mr. is the first Chairman of the Board and will serve a three-year term. *Id.* at Section 5.6.(a). will appoint Mr. to a second term unless Mr. declines then can appoint whoever it chooses. *Id.* at Section 5.6.(d). The first Vice Chairman of the Board is the CEO of who shall serve a three-year term. will reappoint the CEO of as Vice-Chairman unless he declines in which case has discretion to choose. The Company does not compensate the directors (see Operating Agreement section 5.4.(f)) except the Chairman. *Id.* at section 5.6.(c).

The Board of Directors has reserved powers for the following (see Operating Agreement sections 9.1.(a)-(dd)):

- Approving the 3/5 year strategic plan, Annual Operating Plan and related forecasts (e.g. available cash), investment strategies for

importing and exporting brands, integration and synergy plans, and related party transactions.

- Material changes to brand repositioning, recipes, process, reformulation of brand line extensions, introducing new brands, packaging graphics, and anything to materially affect the brand outside the Territory (i.e. U.S.A.).
- Appointing and removing the CEO and his compensation. Approving recommendations of the CEO and Compensation Committee.
- Approving any capital structure change (e.g. reorganizations or equity interests), strategic relationships, material transactions outside the ordinary course of business.
- Decisions to open or close license a brand, acquire a brand, sale of brand outside the United States, and changes in royalty rates, and any material agreement to use or exploit IP outside of the Brand Cooperation Agreement.
- Deadlocks at the Board are sent to the CEOs of and to be resolved and if they cannot be resolved there they are sent to arbitration. *Id.* at section 12. Deadlocks surrounding the Annual Operating Plan revert to the previous year's plan adjusted for inflation. *Id.* at section 12.9.

The Operating Agreement provisions discussed above show that was unitary with because there were economies of scale, centralization of management, and functional integration.

There were economies of scale because the directors, except for the Chairman, served without compensation from Therefore, received the benefit of their services at the expense of the partners.

There was centralization of management because all the power is vested in the directors which were appointed by the partners, and were employees of and solely accountable to the partners. With the exception of the Chairman, did not compensate the directors; instead, they were compensated by the partners. Therefore, and the partners shared the services of the directors.

Additionally, the directors' services consisted of management because they met six times a year and were responsible for approving the strategic plans, the annual operating plan, executive compensation, manufacturing changes (e.g. recipe changes, process changes, etc.), brand operational matters, capital structure changes, royalty rates, and brand matters outside the U.S. and the Bran Co-operation Agreement.

There was functional integration because [redacted] Board was making decisions that affect the operations of the [redacted] water's-edge unitary group when they decided on related party transactions, manufacturing changes, and branding changes to product that gets sold through related parties, the exploitation of IP outside the U.S. or Brand Co-operation Agreement. There is also a pooling of products and trademark IP that the Board was required to approve when product is sold and distributed outside of its defined territory.

3.5.4.1.2. Company Officers

The CEO of the Company is responsible to the Board and the Board delegates to him authority to act. *Id.* Section 7.1. Two [redacted] directors can request the CEO's resignation at any time after the second anniversary of the Company. *Id.* at section 7.2.(b). [redacted] does not have that right. *Id.*

[redacted] is entitled to nominate the CCO to be the second CEO of the Company and [redacted] is required to approve the nomination. *Id.* at section 7.2.(d). [redacted] makes no nomination here. *Id.* If [redacted] does not nominate the CCO, and the Board can find a suitable candidate within [redacted] it will nominate such, otherwise [redacted] was to make a list of candidates which would include a candidate from [redacted] if available, not more than two candidates from the [redacted] one candidate nominated by [redacted] and one external candidate. *Id.* at section 7.2.(e).

The CCO and President, CFO, and CIO all act under the delegations of authority from the Board and [redacted] can request the CIO's resignation after eighteen months from the date of the Operating Agreement. *Id.* at sections 8.4.- 8.6.

This shows that there is centralization of management because the officers are under the control of the Board who are solely responsible to the partners. This also shows that [redacted] directors' control who gets appointed to be officers of

3.5.4.1.3. Capital Structure, Distributions, and Classes of Stock

The Operating Agreement had the following provisions for its capital structure, distributions, and classes of stock.

- There are two classes of stock, Class A and Class B. Class B shares rank equally in all respects to Class A except they are non-voting. *Id.* at section 18.1.

- All available cash is distributed to the shareholders monthly, in proportion to shareholder ownership (58% 42% *Id.* at section 16.1.
- Profits and losses are allocated in proportion to shareholder ownership (58% 42% *Id.* at section 17.1.
- If the Company requires funding, it shall be in proportion to shareholder ownership. Any shareholder loans shall be para-passu to each other. *Id.* at section 13.3.- 13.4.

The monthly distributions shows that there is centralization of management and functional integration because the excess cash is being managed by the partners, and in this case gets 58% of the cash distribution. Additionally, the monthly distribution of all available cash and the requirement for future capital contributions to meet funding needs, shows is in a unitary relationship and not a passive investment.

3.5.4.2. The Services Agreement

The Services Agreement provides the following:

- will provide services to on an actual cost-plus two percent basis. Services Agreement ¶ 3.1.
- Per Schedule 1, the services provided to included the following:
 - Office space provided at cost.
 - A complete marketing function which includes planning and development of product and marketing material for the U.S. and international markets. This included advertising, media, public relations, merchandising, promotions, events, and alliance.
 - A complete supply chain operation which included order management and product supply for export markets, transportation and logistics services, access to transportation and billing systems, repack materials, product samples, invoice preparation to international customers, insurance, forecasting, managing distributors and distributor data, and all phases and documentation of transportation, shipment, and export, and customer service ordering and setup.
 - A complete procurement function for all marketing materials for international markets and all marketing materials to cover customer ability to order and receive marketing materials.
 - A complete operations function to support licensee brewers which includes there is adequate QA, training, capital expenditures, manufacturing guidelines, systems, and procedures. Monthly

sampling, monthly data analysis, and to issue reports. Maintain annual licensee matrices, provide technical advice to licensees, audit licensees 2x per year, and host licensee summit in Provide support for product and packaging development MGD in

Perform product recall including logistics, operations, quality, customer service and finance.

- A complete finance function to perform payroll (2x monthly), financial reporting and analysis, accounting services for vendor and customer service, accounts payable/processing, accounts receivable accounting and processing, T&E, tax reporting for U.S. tax advice, SOX compliance, PwC audit services, internal audit, invoicing, distributor financial services, insurance, and treasury services which includes cash, bank accounts, interest rate swap, debt accounting, and bank analysis.
- A complete human resource function which includes learning solutions support, performance management tools, relocation services, talent acquisition services, compensation support, merit planning and support, organizational development, HR generalist HR policy support for Access to fleet program and immigration support.
- A complete communications department for sales team from U.S. into international markets, video management (U.S. and international), general and governmental communication, customer service from customer service team to international services.
- Shared benefit plans to provide opportunities to employees to participate in benefit health plan and 401K, pension, health benefit coverage, defined contribution plan and health benefit plan.
- A complete information technology function that provides information technology services, managing international packaging visuals, fulfilling marketing material management, access to sales communication tools for U.S. brands into international markets, access to transportation and billing systems, phone network, network service purchase and maintenance of all hardware and software, helpdesk, new user setup and support, manage employee benefit systems, (payroll, pension, 401K, compensation, HR), manage vendor and customer structure to support marketing process materials, assist with credit worthiness of distributors/customers, collections, access to accounting systems, access to various systems, ensure payroll system is working, general ledger and financial reporting technology, and support SAP for separate company codes and all financial system components.

provided all services to [redacted] for its marketing, supply chain, IT, benefit plans, communications, human resource, procurement, accounting functions, as well as the office space to perform those functions. This shows that functional integration, economies of scale, and centralization of management are present to be a unitary business. Centralization of management was present because the [redacted] employees were performing the services of [redacted]. Functional integration exists because of the pooling of resources by having [redacted] provide the staff and perform the marketing, supply chain, IT, benefit plans, communications, human resource, procurement, accounting functions, and the office space to perform those functions. The fact that there is a two-percent mark-up on these services does not negate functional integration because there is still a sharing of resources which benefits both parties because the parties do not have the full burden of having their own independent resources. See IDAPA § 35.01.01.342.01.a. This resource sharing also shows economies of scale because both [redacted] and [redacted] are sharing the burden of having these employees versus each company having its own independent staff and resources.

3.5.4.3. The [redacted] Agreement

The [redacted] Agreement provides the following products and services exchanged between [redacted] also a member of the water's-edge combined group, and [redacted]

- [redacted] (“International”) a wholesaler and sister corporation to [redacted] will purchase product from [redacted]. See Brewing Agreement at Recital.
- [redacted] will manufacture product (approximately fifty-eight brands of [redacted] for International. *Id.* at Exhibit A.
- [redacted] will provide product to International at actual cost. *Id.* at Article 5.
- International will provide a royalty free, non-transferable, and non-exclusive license to [redacted] to use IP to manufacture product. *Id.* at Article 2.2., 10.
- International will monitor [redacted] quality and assurance at its own expense. *Id.* at Article 2.3.
- International agrees to purchase unused packaging. *Id.* at Article 2.6(b).
- International has the right to change recipes and packaging and bears the costs of implementing those changes. *Id.* at Article 2.7.
- If [redacted] makes changes and changes become universal, [redacted] can require International to adopt changes. *Id.* at Article 7.2.(b)(iii).
- International is to provide [redacted] with monthly product forecasts by sku, weekly shipping forecasts by sku, and purchases orders weekly. *Id.* at Article 2.8.(a), (b), (e).

- International will abide all _____ policies and procedures for inventory, storage, and return of dunnage. *Id.* Article 2.11.(c).
- International will pay _____ for dunnage at the price charges its wholesalers and _____ will refund International for dunnage at a price that _____ pays its wholesalers. *Id.* at Article 2.11.(d).
- _____ will provide the following services which do not overlap the Services Agreement: procurement, order processing, storage, logistic (at International’s request), freight, management (at International’s request), warehousing, and loading, and forecasting. These services are reimbursed at cost. *Id.* at Articles 3.1., 7.3., 7.5., 7.8., 7.9., 7.10.
- International will purchase unsaleable product unless the product becomes unsaleable because of _____ fault. *Id.* at Article 6.3.
- International is responsible for obtaining government approvals and licenses. *Id.* at Art 8.
- _____ will maintain liability insurance for the term of the contract. *Id.* at Article 11.3.
- Disputes between International and _____ are referred to the employees involved in the matter to resolve the dispute. *Id.* at Article 15.

Functional integration and economies of scale are present here because _____ is providing to International services at cost, _____ fifty-eight brands of _____ at cost, and dunnage at cost. Also International is providing to _____ quality control at zero cost, use of intellectual property at zero cost (royalty free), and indemnification of unsaleable product provided _____ is not at fault for making the product unsaleable.

Centralization of management exists because _____ is providing procurement, order processing, storage, logistic (at International’s request), freight, management (at International’s request), warehousing, and loading, and forecasting services to International.

3.5.4.4. The Brand-Cooperation Agreement

The Brand Co-operation agreement between _____ and _____ provides the following:

- Section 2 “IMPORTS” requires the shareholders of _____ and their parent companies to enter into royalty and supply agreements for certain brands of _____ they import into the U.S. The shareholders can add additional brands to the brands imported with the approval of _____

- Board. If the Board approves the brand for import, the shareholder will enter into a Royalty Agreement and Supply Agreement with
- Section 3 “EXPORTS” requires Board to approve the export outside of the U.S. of any new brands that develops. The importing activity is controlled by the shareholder with the largest market share in the country of import. The controlling shareholder will handle the importing, sales, and distribution in the country of import.
 - Section 4 “CONTRACT” provides that will enter into a

“The Company shall enter into, and shall procure that enters into, a agreement and an alternation agreement in the forms agreed by such parties as of the date hereof (each of the agreement into pursuant to the Section 4, ‘a Contract Brewing Agreement’).”
 - Section 7 “LINE EXTENSIONS” provides that will own the trademarks and IP rights associated with “line extensions”, which are product expansions, that develops, in the U.S. However, will own the trademarks and IP outside of the U.S. on the line extensions developed. Section 7.2. provides the same for
 - In Section 8 “DEVELOPED OR ACQUIRED INTELLECTUAL PROPERTY,” it provides that if the Company develops or acquires IP (excepting Sections 3 and 7), the Company shall own the IP in the U.S. and outside the U.S. The Company will grant a non-exclusive and royalty-free license to the shareholders to use the IP outside of the U.S. unless the Board determines otherwise. In section 8.2 it provides that the shareholders shall but are not obligated to share with the IP they develop or acquire.
 - Section 10 “PROTECTION OF INTELLECTUAL PROPERTY RIGHTS” provides that will protect its IP rights otherwise it will notify the shareholders and they shall have the right to renew such trademarks and licenses at their own costs.
 - Section 11 “DOMAIN NAMES” The parties agree to permitting links and functionality between their websites and the shareholders and will share the IP needed to accomplish such, on a royalty free, worldwide basis for marketing the party’s products. Also, the parties agree to license the wider and groups to use trademarks in the U.S. Appendix 1 to the contract shows the links between internet sites and shareholder sites.
 - Section 12 “OTHER COMPANY LICENSES” provides that the CEO of will make the determination of whether a license will be granted to the shareholder(s), at their request, to use IP or IP, as the case may be, so long as it is not detrimental to The

terms of the license shall be non-exclusive, royalty bearing, irrevocable, perpetual, within and outside the U.S.

- Section 13 “CONFIDENTIALITY OF TRADE SECRETS” states that [redacted] will protect the shareholder trade secrets as if they were owned by [redacted] and [redacted] respectively. The [redacted] and [redacted] will protect the respective trade secrets they own outside the U.S. as if they were [redacted] trade secrets.
- Section 16 “ARBITRATION” provides that the parties will attempt to settle disputes by first going to the CEOs of [redacted] and [redacted] before going to arbitration.

The “IMPORT” and “EXPORT” sections show a unitary relationship because the [redacted] Board must approve all import and export decisions and the directors are employees of the partners. This meets the centralization of management.

The “CONTRACT” [redacted] provision shows a unitary relationship because it is requiring that [redacted] the parent company, have International, wholly owned subsidiary, enter a [redacted] contract and an alternation contract in the forms agreed to by the signing parties. This shows that [redacted] is controlling the activities of its subsidiaries.

The “LINE EXTENSIONS” section shows functional integration because [redacted] retains the IP for its product developments in the U.S., but the IP goes to the partners outside of the U.S. therefore the value of the IP used internationally is being transferred.

The “DEVELOPED OR ACQUIRED INTELLECTUAL PROPERTY” section provides that [redacted] will provide a license to its partners, royalty free, to use IP it acquires, outside the U.S. This shows functional integration and economies of scale because [redacted] is transferring value to its partners at zero cost.

Functional integration and economies of scale also exists in the section “DOMAIN NAMES” because [redacted] is allowing its partners to use its websites, at zero cost, and provide the IP and trademarks to allow the partners access for the purpose of marketing product. This shows functionally integration and economies of scale because there is transfer of value by providing a website and the separate companies do not have to bear the burden of having their own independent website for marketing product.

Centralization of management is present in the “ARBITRATION” section because the CEO’s of the partners are to try to settle disputes before they go to arbitration.

3.5.4.5. The Taxpayer's Previous Tax Filings Show in a Unitary Relationship

is

Since its inception in 2008, has shown the income from as business income. The Supreme Court of Idaho has stated that the unitary business test is “part and parcel of the ‘business income’ question.” *Noell Industries, Inc. v. Idaho State Tax Commission*, 167 Idaho 367, 372 (2020). The Supreme Court of Idaho further stated that “‘business income’ can be established by either the unitary-business test or by 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.’” *Id.* at 373. By filing returns showing the income from as business income, is stating they are unitary with which meets the entity unity test discussed above in section 3.4.2.1. Alternatively, is stating its partnership investment is an integral, functional, or operative component to the business and not a passive investment, which meets the asset unity test discussed in section 3.4.2.1.

filed a water’s-edge election with the following corporations:

and Under Idaho Code section 63-3027D(a), the members of the water’s-edge group are presumed to be unitary and all the income therefrom is apportionable. Consistent with their water’s-edge filing, the income of from is apportionable.

3.5.5. Applying the Enterprise Unity and Asset Unity Test

In applying enterprise unity and asset unity analysis, the result is the same.

Under the enterprise unitary test, is unitary with and the other members of the combined water’s-edge group, therefore the gain is apportionable. This is based on the following: the taxpayer’s filing history where the partnership income is reflected as business income which shows a unitary relationship; having property, payroll, and sales in Idaho; elected to file a water’s-edge combined return with other unitary members; and most importantly, based on the intercompany transactions and relationships discussed in section 3.5. *supra*.

Under the asset unity test, partnership interest in did not serve an investment function but was an integral part of the unitary operations of manufacturing and distributing therefore the gain is apportionable. The relevant fact is that the partnership interest is an integral part of a unitary business, not that the taxpayer is in the trade or business of selling

partnerships. Therefore, the sale of the partnership interest meets the function test for business income under Idaho Code section 63-3027(a)(1). The evidence is the same as the bullet above.

3.6. Conclusion that [redacted] is Unitary with [redacted] and the Water's-Edge Combined Group

We uphold the finding that [redacted] is unitary with [redacted] and the combined water's-edge group, therefore [redacted] sale of its partnership interest is apportionable. [redacted] operated in Idaho as shown by the fact it had property, payroll, and sales in Idaho. [redacted] is unitary because economies of scale, functional integration, and centralization of management were present with the members of the water's-edge group. Because of the unitary relationship, the sale of the partnership interest meets the enterprise unity test and the asset unitary test. This determination is consistent with the taxpayer's previous filings where they filed as a combined unitary water's-edge group and reflected the income from [redacted] as business income of the combined group.

4. Penalty

We uphold the Audit Bureau's assertion of the penalty under Idaho Code section 63-3046(a) due to "negligence or disregard of the rules" and Idaho Code section 63-3046(d) for substantial understatement. We uphold the penalties because the taxpayer's position on "Business Income" is contradictory to the facts and their previous tax filings and elections to the State of Idaho.

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____
2023, 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.
