

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of

██████████

Petitioner.

DOCKET NO. 1-800-889-344

DECISION

██████████ (Petitioner) protested the Notice of Deficiency Determination (Notice) dated April 21, 2022, issued by the Income Tax Audit Bureau (Bureau). Petitioner disagreed with the Bureau's adjustments to their apportionment factor. The Idaho State Tax Commission (Tax Commission) reviewed the matter and for the reasons stated below modifies the Notice.

BACKGROUND

Petitioner is a corporate taxpayer with its principal place of business in Minneapolis, Minnesota. Petitioner is a provider of diversified financial services and conducts business activities through its subsidiaries within and outside Idaho. Many of Petitioner's subsidiaries are members of Federal Deposit Insurance Corporation and the Federal Reserve System.

The Multistate Tax Commission (MTC) conducted an audit of Petitioner's Idaho corporation income tax returns for tax years 2017 through 2019¹. Upon completion of the audit, the MTC provided their findings to the Tax Commission, recommending the Bureau adjust Petitioner's apportionment factor along with various other adjustments.

¹ Idaho is a compact member of the MTC and authorized them to review Petitioner's Idaho returns.

The Bureau adjusted Petitioner's apportionable income and apportionment factor as the MTC recommended and sent Petitioner a Notice². Petitioner protested the Notice, disagreeing with the Bureau's adjustments to the apportionment factor. One of the adjustments is to the 2017 beginning balance of Idaho property for [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED]. The Bureau added its 2017 ending balance as its beginning balance. In the protest, Petitioner argued that, since [REDACTED] [REDACTED] [REDACTED] [REDACTED] acquired participation in loans sourced to Idaho in the middle of 2017, the 2017 beginning balance of Idaho property should be zero. Based on this information, the Bureau adjusted the property numerator of [REDACTED] [REDACTED] [REDACTED] [REDACTED] and issued a modified Notice. Petitioner received the modified Notice but informed the Bureau of their continuous protest. 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 and requested an informal hearing, which was held on November 7, 2024. At the conclusion of the informal hearing, Petitioner accepted the property numerator of [REDACTED] [REDACTED] [REDACTED] as adjusted by the MTC and [REDACTED] [REDACTED] [REDACTED] [REDACTED] as modified by the Bureau; therefore, this decision will not address these adjustments any further, and the Tax Commission, having reviewed the file, hereby issues its final decision.

ISSUES

The issues on appeal are the apportionment factor, property numerator (i.e. loan assignment) and sales numerator (i.e. sourcing service fees) of [REDACTED] [REDACTED] [REDACTED] and all the denominators. As for the denominators, Petitioner disagrees with the exclusion of pass-through

² Petitioner did not protest the apportionable income adjustment; therefore, the Tax Commission will not address it further in this decision.

³ [REDACTED] [REDACTED] [REDACTED] [REDACTED] is a unitary member of Petitioner.

attributes from certain partnerships, and the inclusion of negative amounts⁴ in the denominators. Additionally, regarding the payroll denominator, Petitioner disagrees with the exclusion of the wages paid to foreign disregarded entities.

LAW AND ANALYSIS

Numerators in Apportionment Factor

Property Numerator

In 1994, the MTC issued a recommended formula for the apportionment and allocation of net income of financial institutions (MTC financial rule)⁵, and the Tax Commission adopted the MTC financial rule in Idaho Income Tax Administrative Rule 582. The MTC financial rule⁶ contains variations from Idaho's standard apportionment methods set forth in Idaho Code section 63-3027. Variations, that are particularly significant in this case, are the inclusion of intangibles, i.e. loans, in the property factor and the apportionment of intangibles to a state where a loan has a preponderance of substantial contacts, i.e. solicitation, negotiation, investigation, approval, and administration, or SINAA⁷. As for a definition of "loan", the MTC financial rule section 2(j) provides:

"Loan" means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. Loans include participations, syndications, and leases treated as loans for federal income tax purposes. Loans shall not include: properties treated as loans under Section 595 of the Federal Internal Revenue Code; futures or forward contracts; options; notional principal contracts such as swaps;

⁴ Petitioner is the parent of many subsidiaries. Some of these subsidiaries reported negative numbers of gross receipts, other income, wages and salaries, and rent expenses on their federal returns. In calculation of the apportionment factor, the amount of these items should not be less than zero. The negative amounts in their federal returns were potentially caused by inclusion of contra-revenues/expenses or mismatch in accounting periods in recognizing revenues/expenses.

⁵ Idaho Income Tax Rule 003.02. MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions. This rule incorporates the MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions as adopted November 17, 1994.

⁶ Although the MTC amended the financial rule in 2015, since Idaho has not adopted the 2015 amendments, the "financial rule" means that is as adopted in 1994.

⁷ MTC Recommended Formula section 4(g)(1)(A) as adopted November 17, 1994.

credit card receivables, including purchased credit card relationships; non-interest bearing balances due from depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.

In determining where a loan has a preponderance of substantive contacts, “the facts and circumstances regarding the loan at issue shall be reviewed on a case-by-case basis and consideration shall be given to such activities as the solicitation, investigation, negotiation, approval and administration [SINAA] of the loan.”⁸ If the preponderance of substantive contact regarding a specific loan takes place at an Idaho branch or office, the loan is treated as being located within Idaho.

In the present case, there is no dispute that [REDACTED] [REDACTED] [REDACTED] is a unitary member of Petitioner and considered a “financial institution”. However, Petitioner disagreed with the apportionment of “margin loans”⁹ to Idaho and argued that none of their margin loans had preponderance of substantive contacts in Idaho based on their SINAA analysis.

[REDACTED] [REDACTED] [REDACTED] provides margin loans through its disregarded entities, i.e. [REDACTED] [REDACTED] [REDACTED] ([REDACTED] and [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] ([REDACTED] [REDACTED] delivers execution and clearing of futures and options to institutional customers and provides direct market access and algorithmic trading strategies for self-execution of futures and options.

[REDACTED] primarily provides financial advisory services, investments, brokerage services and online trading services under the trade name of “[REDACTED] [REDACTED] [REDACTED] within and outside

⁸ MTC Recommended Formula section 4(g)(3) as adopted November 17, 1994.

⁹ A margin loan is a loan from a broker to a client that functions as a margin account and allows a client to borrow against the value of securities the client already owns.

Idaho. Petitioner's organizational hierarchy categorizes these disregarded entities as "securities broker/dealer", non-bank affiliates.

The MTC audit information states Petitioner did not provide their SINAA analysis upon request. However, Petitioner did provide their analysis, which the Tax Commission will now review.

Petitioner's SINAA analysis provides descriptions of their margin loans¹⁰ and explains their processes, i.e. application, approval, loan fund disbursement, and administration as follows:

[REDACTED]

A customer can apply for a margin loan by applying for a margin account. A margin account application is completed and customer is provided with a Margin Disclosure Statement and is required to sign a Margin Agreement. The margin application may be initiated through an advisor at an advisor's office location but are typically initiated via correspondence (online, phone, email, and mail). A customer can apply for a Priority Credit Line^[11] by working with an advisor, following similar process as for margin loans. A customer is provided with a Priority Credit Line Disclosure and is required to sign a Federal Reserve Form T-4, which covers the loan agreement.

Approval process is in accordance with the established policy for securities based loans/lines, including regulatory requirements, house collateral requirements, and account eligibility, all established outside of the above listed states^[12]. For [REDACTED] approvals are done in Missouri.

The process of disbursing (withdrawing and borrowing) funds depends on the type of margin credit. Priority Credit Line (PCL) – customers can access funds via check, ACH, or wire transfers, handled by operations. Margin – purchases of securities are settled from the margin loan by operations. Funds can also be accessed using on-line tools.

¹⁰ Petitioner provided their SINAA analysis as their response to the MTC's information request regarding several states (Alaska, Arkansas, Hawaii, Idaho, New Mexico, North Dakota, and Utah).

¹¹ Petitioner's SINAA analysis explains that "Priority Credit Line (PCL), a demand credit facility, is a flexible line of credit based on eligible securities in WFA brokerage account and Margin credit, a demand credit facility, is an extension of credit for the purpose of purchasing, carrying or trading in securities, and can be used like a line of credit. The terms vary based on securities purchased/held as collateral and regulatory margin regimes and [REDACTED] regulatory-approved house margin calculation for various margin offerings."

¹² Petitioner's SINAA analysis addresses the margin loans in Alaska, Arkansas, Hawaii, Idaho, New Mexico, North Dakota, and Utah.

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Margin capacity, cash management, and security buys and sells are facilitated by the prime brokerage account. Disbursement of funds is a function of cash management activity and securities transactions.

A Prime Brokerage Customer Agreement is required to be signed by a customer to open a Prime Broker Account (“PB Account”). Per the terms of this agreement, ██████████ may lend customer funds via margin loan or securities loan. There is no separate application. The sales staff is located outside of the above listed states ^[13], mostly in New York, North Carolina, Minnesota and California.

Most margin lending agreements are overnight in nature. In overnight agreements the prime broker reserves the right to change margin requirements and/or pricing ‘on demand.’ A subset of clients, typically the top tier, can have term agreements that afford the client and their investors a longer notice period to change margin requirements and/or pricing. All clients are required to meet their margin requirements on a daily basis, regardless whether term or overnight.

The approval process is very extensive. It includes line of business vetting, margin analysis; independent credit risk management review; Financial Crimes and Anti-Money Laundering review; Legal and Compliance review. Any objections to the opportunity including but not limited to perceived reputational risk, concentration risk concerns, credit quality concerns, platform capability shortcomings to provide adequate service, and more are raised and could stop the opportunity from becoming ‘approved.’

As for their administration process –

The administration process for margin financing encompasses various activities related to stringent compliance with the established credit policies (including regulatory margin regimes and ██████████ regulatory-approved house margin calculation for various margin offerings), compliance with terms of the agreements (including issuing maintenance calls and/or selling securities or other assets in order to maintain the required equity in client account), and compliance with various laws applicable to brokerdealers as it relates to margin financing.

All administration activities are performed outside of the above listed states. Client services, administration/ongoing monitoring, other margin and priority credit line related functions are performed in Missouri for ██████████ For ██████████ margin

¹³ Petitioner’s SINAA analysis addresses the margin loans in Alaska, Arkansas, Hawaii, Idaho, New Mexico, North Dakota, and Utah.

financing team has offices in New York, California, Massachusetts and Texas; client Services' staff is in New York, North Carolina and California; and operations staff is in New York, North Carolina and Minnesota.

After careful consideration of Petitioner's SINAA analysis and activities conducted by [REDACTED] [REDACTED] [REDACTED] and its disregarded entity, the Tax Commission finds that they did not have preponderance of substantive contacts in Idaho; therefore, the margin loans of [REDACTED] [REDACTED] [REDACTED] are not apportionable to Idaho at this time.

Sales Numerator

The MTC financial rule section 3(l) provides the apportionment of receipts from services:

... If the service is performed both within and without this state, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this section, if a greater proportion of the income-producing activity is performed in this state based on cost of performance.

Petitioner did not provide, nor did they conduct a cost of performance analysis regarding [REDACTED] [REDACTED] service fees. Instead, Petitioner explained during the hearing that they apportioned the services fees to Idaho as a proportion of the wages paid to Idaho employees in the total wages paid to all employees as an equitable apportionment of their income as provided under Idaho Code section 63-3027(s):

If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the state tax commission may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Based on the explanation Petitioner provided during the hearing, the Tax Commission finds that Petitioner's apportionment of service fees is acceptable. Therefore, the Tax Commission will accept the sales numerator as shown on their original returns.

Denominators in Apportionment Factor

There are two primary issues regarding the denominator of the apportionment factor: one is the inclusion of a corporate partner's share of the partnership property, sales, and payroll in the denominators, and the other is the inclusion of negative amounts in the denominator. Petitioner stated in their protest:

The typical state tax auditing practice, including the approach used by Idaho auditors in its prior audits of the Taxpayer's returns, is to review the Taxpayer's denominators as filed and adjust them as the auditors see fit. Contrary to such common practice, however, the MTC simply discarded the Taxpayer's denominators and started building them from scratch. In its apportionment schedules, the MTC used the Taxpayer's 2017-2019 federal consolidated tax returns, rather than the Taxpayer's apportionment workpapers, as the basis for calculating the Taxpayer's denominators.

The protest indicates that the MTC's usage of the federal consolidated tax returns in developing apportionment factors results in netting gains and losses unnecessarily and omitting certain flowthroughs, which led to a material discrepancy in the denominators. The Tax Commission reviews whether the inclusion of the flowthroughs fairly represents Petitioner's business activities in all states for the years under current review.

Inclusion of Corporate Partner's Share of Partnership Factors

Idaho Income Tax Administrative Rule 620.04.b. Factors, provides in pertinent part:

A corporate partner's share of the partnership property, payroll, and sales after intercompany eliminations, is to be included in the numerators and the denominators of the partner's property, payroll, and sales factors when computing its apportionment formula. The partner's share of the partnership's property, payroll, and sales is determined by attributing the partnership's property, payroll, and sales to the partner in the same proportion as its distributive share of partnership income if reporting net income for the taxable year or in the same proportion as its distributive share of partnership losses if reporting a net loss for the taxable year.

The flowthroughs, which according to Petitioner, contributed to a material discrepancy in the denominators, are from [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED]¹⁴ and the numerous partnerships, in which [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] had interest. Petitioner provided the flowthrough amounts that they included in their denominators (which the MTC excluded) and explained that these amounts must be included to fairly represent their business in all states.

Petitioner, as a unitary group, owned hundreds of partnerships. However, the Notice issued by the Bureau based on the MTC audit only included the flowthrough from [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] in its calculation of the denominators, which resulted in an unfair representation of Idaho business. The Tax Commission agrees and finds that Petitioner's inclusion of the flowthroughs from [REDACTED] and the partnerships owned by [REDACTED] fairly represents their business in all states. Therefore, the Tax Commission accepts the inclusion of the flowthroughs in the denominators as originally reported by Petitioner.

Negative Amounts

Idaho Income Tax Administrative Rule 450.01., provides in pertinent part:

... The element of the apportionment formula are the property factor, the payroll factor, and the sales factor... **The denominator of each factor may not exceed the sum of the numerator of that factor.** (emphasis added)

When calculating their property denominator, Petitioner removed the rent expenses, that are reported as negative amounts on line 16, federal consolidated tax returns. After the hearing, Petitioner explained that "a negative rent primarily occurs when a company receives a refund of rental expense due to a mismatch in accounting periods and/or how rent is allocated." Petitioner

¹⁴ [REDACTED] is a partnership owned at 60% by [REDACTED] [REDACTED] [REDACTED] .A., who is a unitary member of Petitioner.

¹⁵ [REDACTED]

¹⁶ [REDACTED]

further explained that some of the negative rents are intercompany rental income included in an expense account, instead of included as contra-income in a revenue account. To prevent an understatement of the rent expense, Petitioner removed the negative amounts as these are not a reduction in rent expense. Petitioner argued that, if the negative rent expenses are included in the property denominator, they must be included in the property numerator, otherwise, the property denominator would exceed the sum of the property numerator. Additionally, Petitioner argued that the Notice failed to include the rent expenses under the “other deductions” on line 26, federal Form 1120, and this amount should also be included in the property denominator. Petitioner provided details of the other deductions, and Appeals verified that the Notice did not include the rent expenses in the other deductions. The Tax Commission finds Petitioner’s arguments are valid. Therefore, the Tax Commission accepts the property denominator as shown on their original returns.

As for the negative amounts in the sales denominator, Petitioner removed unrealized losses reported under the “other income” on line 10, federal Form 1120, while calculating their sales denominator. For federal purposes, unrealized gains and losses on intangibles would be a component of the other deductions on line 26, Form 1120. However, Petitioner reported them as part of the other income on line 10, federal Form 1120, which resulted in an understatement of the sales denominator. The MTC financial rule, section 3. Receipts Factor provides the receipts from intangibles should be included in the apportionment factor at net of gain and loss, and the net amount must not be less than zero. The Bureau’s inclusion of Petitioner’s unrealized losses in the sale denominator resulted in an understatement of their sales denominator, which does not fairly represent Petitioner’s business in all states. The Tax Commission finds that Petitioner’s exclusion

of the negative amounts in calculation of the sales denominator is appropriate. Therefore, the Tax Commission accepts the sales denominator as shown on their original returns.

The last item for review is the payroll denominator. The payroll factor should include only the compensation that is included in the computation of the apportionable income tax base for the taxable year¹⁷. For tax year 2019, Petitioner included the compensation paid by [REDACTED] [REDACTED] [REDACTED] to its foreign disregarded entities. During the hearing, Appeals requested Petitioner provide documentation to substantiate the compensation paid to the foreign disregarded entities. Petitioner responded that, due to the materiality in tax, they conceded the exclusion of the compensation paid to the foreign disregarded entities from the payroll denominator.

CONCLUSION

The Tax Commission finds that Petitioner's calculation of the sales and property numerators of the apportionment factor for [REDACTED] [REDACTED] [REDACTED] is acceptable. The Tax Commission also finds that Petitioner's calculation of all denominators, except for the payroll denominator, is acceptable. After incorporating all the adjustments described above, the Tax Commission modifies the Notice for tax years 2017 through 2019.

The Bureau added interest to Petitioner's Idaho tax. The Tax Commission reviewed the addition and found it appropriate and in accordance with Idaho Code section 63-3045.

THEREFORE, the Notice of Deficiency Determination dated January 19, 2024, and directed to Petitioner is AFFIRMED as MODIFIED by this decision.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2017	\$358,117	\$0	\$78,168	\$436,285
2018	243,819	0	42,812	286,631
2019	481,945	0	58,652	540,597
			TOTAL DUE	<u><u>\$1,263,513</u></u>

¹⁷ The MTC financial rule, section 5. Payroll Factor (a)

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.
