

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of

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DOCKET NO. 1-967-781-888

DECISION

Petitioners.

(Petitioner) protested the Notice of Deficiency Determination dated October 15, 2021. Petitioner disagrees that the income it received from services performed is income that can be 100% attributed to Idaho rather than apportioned based on Idaho’s normal apportionment factors. The Tax Commission reviewed Petitioner’s case and found Petitioner’s performance of services were within the realm of management services and therefore required the use of separate accounting allocating 100% of that income to Idaho.

BACKGROUND

Petitioner is a multi-national corporation of the world’s largest professional services firms

Petitioner is one

a wholly owned subsidiary of

Petitioner, contracted with

as the contractor for the

- at Petitioner filed combined Idaho corporate income tax returns electing the waters-edge treatment.

Petitioner filed amended Idaho corporate income tax returns for tax years 2015 and 2017 reporting changes made to its federal income tax returns. The Income Tax Audit Bureau (Bureau) reviewed Petitioner’s amended returns for the appropriateness of the changes to Petitioner’s Idaho income tax returns. In addition to reviewing the changes made to federal taxable income, the

Bureau asked Petitioner to provide information and/or documentation on the allocated income attributable to _____ the Idaho sales eliminations, and the 2017 net operating loss carryback and carryforward. Petitioner provided the information requested along with other documentation the Bureau later requested. The Bureau reviewed the information and documentation provided and determined that in addition to the changes Petitioner made with its amended returns, adjustments were needed to the dividends received deduction for tax year 2018, to deferred foreign income per Internal Revenue Code section 965 for tax year 2017, to the foreign and deemed dividend exclusion for tax year 2018, to the income reported _____ and to Petitioner's carryback and carryforward of tax year 2017's net operating loss. The Bureau prepared a Notice of Deficiency Determination for the tax years 2015 through 2018 and sent it to Petitioner.

Petitioner protested the Bureau's determination. Specifically, Petitioner disagreed with the Bureau's allocation of _____ income to Idaho. The Bureau based this allocation on Idaho Code section 63-3027(u)¹ which requires separate accounting for certain multi-state or unitary corporations. Petitioner stated it is not subject to Idaho Code section 63-3027(u) because it provided _____ services, not management services as stated in section 63-3027(u). Petitioner stated _____ leads, manages, and administers the _____ only serves as an operating contractor performing _____ services at the facility.

Petitioner also stated Idaho Code section 63-3027(u) is unconstitutional and unenforceable. Petitioner stated section 63-3027(u) discriminates against the United States government violating

¹ All references to Idaho Code section 63-3027(u) are as the statute existed in 2018.

the Supremacy Clause. Petitioner also stated section 63-3027(u) violates the Commerce Clause in that it fails the internal consistency test because it discriminates against interstate commerce in favor of intrastate commerce.

Petitioner stated that even if Idaho Code section 63-3027(u) did apply and even if the code section was constitutional, it would only apply to the portion of Petitioner's revenue connected to the performance of management services at [redacted] Petitioner stated it engaged in [redacted] activities, and any management services were merely incidental to its [redacted] activities and other [redacted] functions. Petitioner stated even if it were found that these incidental activities were enough to warrant separate accounting treatment, the statute states that separate accounting treatment can only be applied to the specific cash payments related to "management services." Accordingly, Idaho cannot impose separate accounting and the allocation of 100% of Petitioner's income from its activities at [redacted] is incorrect.

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 that discussed the methods for redetermining a Notice of Deficiency Determination. Petitioner requested a hearing which was held January 10, 2023. Attending the hearing for Petitioner were [redacted] and attorneys [redacted] (collectively "Representatives"), and hearing the case for the Tax Commission were Commissioner [redacted] Deputy Attorney General [redacted] and Tax Appeals Specialist [redacted]

Representatives provided some background of Petitioner, [redacted] and the project [redacted] was contracted to perform. Representatives stated Petitioner, [redacted] - -

contracted with through its wholly owned subsidiary Petitioner specifically created a separate entity, for the project. The project was part of the

Petitioner began the project in June 2016 and had a targeted completion date of 2021. Representatives stated Petitioner's work in Idaho was . The contract was a performance work contract not a management contract. Representatives stated is run by or managed by Even though Petitioner contracted directly with was the contractor that coordinated the site activities. Representatives stated solicited and gathered proposals for the project and negotiated the contract. Representatives stated had oversight of the project with Petitioner.

When Petitioner filed its Idaho income tax return, it apportioned its business income to Idaho using the normal apportionment method as specified in Idaho Code section 63-3027. Representatives stated the Bureau's adjustment forcing Petitioner to use separate accounting is inappropriate because Petitioner was not performing management services as stipulated in Idaho Code section 63-3027(u). Representatives stated Idaho Code section 63-3027(u) only applies to those who perform "management services directly for the United States government

Representatives stated Petitioner did not provide management services. Petitioner provided other types of services, .

Representatives stated manages Representatives pointed to website that states provides management and administrative services at Representatives stated Petitioner was hired to do specific tasks. Petitioner was not a general manager. Petitioner only managed its own people.

Representatives stated the term management services is not defined in Idaho's statutes. Representatives argue it is not an unreasonable interpretation to say the statute applies to the management of the overall project, . Representatives stated Petitioner is not managing is. Representatives interpret management to mean supervisory or governance. Representatives stated that since Petitioner did not perform management services, separate accounting cannot apply to Petitioner's income from its work at

Representatives also argued that Idaho Code section 63-3027(u) is unconstitutional. Representatives stated Idaho Code section 63-3027(u) discriminates against the United States government and those it deals with. Representatives stated the statute singles out government contractors at and treats them far worse than contractors applying similar services for private entities or the State of Idaho. Representatives cited a recent U.S. Supreme Court case, *United States v. Washington*, 142 S.Ct. 1976, (2022), stating that the Washington statute that was determined unconstitutional is nearly identical to Idaho's statute. Representatives stated the fact that Petitioner is appealing this assessment of millions of dollars in additional tax is proof that Idaho's statute is discriminatory.

In addition to the Idaho statute discriminating against the federal government, Representatives stated the statute violates the Commerce Clause of the U.S. Constitution. Representatives stated Idaho's statute fails the internal consistency test by discriminating against interstate commerce in favor of intrastate commerce. In applying Idaho's statute, Representatives stated, if a taxpayer operates both inside the state where the contract was performed and outside of the state, the taxpayer would always be taxed on more than 100% of their income. Representatives stated Idaho Code section 63-3027(u) fails the internal consistency test because it

treats the same activity differently depending on whether it is performed in Idaho versus outside of Idaho.

During the hearing, the Tax Commission asked for additional information regarding Petitioner's activities at [redacted]. Representatives provided that information as supplements to the hearing within the agreed time. Representatives provided an affidavit of [redacted] the President of [redacted] copies of relevant sections of [redacted] describing the work each party was hired to perform, and a short analysis of why they believe Idaho Code section 63-3027(u) is unconstitutionally discriminatory.

After reviewing all the information provided the Tax Commission issues its decision based on the following law and analysis.

LAW AND ANALYSIS

The issue in this case is the treatment of income received from the performance of contract work done at [redacted]. Petitioner reported the income using the apportionment method for multi-state taxpayers. The Bureau, after a review of Petitioner's activities, determined the activities fall into the special provision of Idaho Code section 63-3027(u) which requires separate accounting of the business activity.

Idaho Code section 63-3027(u) stated,

If compensation is paid in the form of a reasonable cash fee for the performance of management services directly for the United States government at the Idaho national laboratory or any successor organization, separate accounting for that part of the business activity without regard to other activity of the taxpayer in the state of Idaho or elsewhere shall be required; provided that only that portion of general expenses clearly identifiable with Idaho business operations of that activity shall be allowed as a deduction.

Petitioner argued two points with regard to the adjustment made by the Bureau. The first is that Petitioner did not perform management services in the fulfillment of its contract with the

The second is that even if Petitioner performed management services, Idaho Code section 63-3027(u) requiring separate accounting is unconstitutional.

Addressing Petitioner's second argument first, state agencies do not have the authority or ability to pronounce a state law unconstitutional. "[T]he question of a statute's constitutionality is a judicial problem that only the courts have power to decide. It is not a proper question for determination by an administrative board even though it may in its normal proceedings exercise quasi judicial powers." *Wanke v. Ziebarth Const. Co.*, 69 Idaho 64 (1948). The Tax Commission's authority and duty is assessing and collecting Idaho's taxes.² Therefore, the Tax Commission declines to offer an opinion as to the constitutionality of Idaho Code section 63-3027(u).

Petitioner argued that its contract was not for management services. Petitioner stated the contract was for services and therefore separate accounting is not required. Petitioner asserts that was the manager and provided all management and administrative services

Management services is just one of the requirements of Idaho Code section 63-3027(u) to require separate accounting, but it is the one that is the least clear. Management services is not defined in the Idaho Code. Petitioner argued management services are supervisory and governance functions. The Bureau on the other hand sees management services as operational.

Petitioner submitted copies of pertinent sections of contract
Petitioner stated it is clear that the true object of the contract was for services and that

² See Idaho Code section 63-105.

any management services were incidental to this primary purpose. Petitioner stated
was an operating contractor
primary business activities included services.
Petitioner stated was hired to oversee the operations of whereas was
hired to perform specific tasks.

The Tax Commission reviewed the contract copies Petitioner provided to glean any
information regarding Petitioner’s activities, authority, and relationship with Upon
reviewing the contracts, the Tax Commission found two distinct areas of operation. Both Petitioner
and are referred to as “Prime Contractors”. was contracted to “provide, in a cost
efficient manner, the personnel, materials, supplies, and services necessary to manage and operate
pursuant to Section C, Statement of Work, or as directed by
the Contracting Officer.”³ is responsible for managing and operating .⁴

In contrast, contract is a contract with to accomplish the
being the Prime Contractor
for the contract was required “to perform all work specified in the contract and to

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⁵ *Id.*

determine the specific methods of accomplishing the work.”⁶ As contractor, was required to interface with the other contractors⁷, which included Among the objectives and goals was to accomplish were goals 3 and 4,

Goal 3: Improve management of contracts and projects/operations activities with the objective of delivering results on time and within cost.

Goal 4: Achieve excellence in leadership and resource management by championing financial stewardship, integrating business processes, optimizing EM culture change, and improving communications with the objective of enhancing accountability and achieving performance results.⁸

These goals by themselves show that was managing all aspects of the contract.

After reviewing portions of the respective contracts, it is apparent and had two different and distinct contracts with the to fulfill specific purposes. oversaw and managed the daily operations and functions managed and oversaw the

Each was a Prime Contractor, and each was responsible for the goals and objectives of their respective contracts. and were also required to interact with each other in so much as they were required to have and maintain an Interface Agreement.⁹ In addition to an Interface Agreement, and entered into a Blanket Master Agreement.¹⁰ This agreement recognized each as holding prime contracts and the need for one another to perform specific services in support and within the scope of their respective prime

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⁷ *Id.*

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contracts. The agreement set forth the scope of work and the respective services each was to perform.

Petitioner argued [redacted] did not perform management services [redacted]. However, the [redacted] contract is clear that [redacted] is the contractor that has full authority, governance, supervisory, and operational control over the objectives and goals of the contract subject only to the oversight of the contracting officer. [redacted] also had the ability to subcontract out portions of its contract and in fact did hire subcontractors.¹¹

Petitioner argued the term management services should be narrowly construed and limited to only the management [redacted] overall thereby making [redacted] the only one subject to Idaho Code section 63-3027(u). The Tax Commission, however, believes the term was intended to have a broader meaning. The Tax Commission believes management services apply to anything that one has oversight, governance, supervisory, control, or administration over. [redacted] as the Prime Contractor of the [redacted] contract, exercised all those functions in the completion of the contract. Granted, the [redacted] contract was for [redacted] but as the Prime Contractor [redacted] had the authority to manage that remediation in the manner it saw fit in accordance with the restrictions of the [redacted] agreements and the contract. [redacted] managed the [redacted] and therefore provided management services [redacted] for the [redacted].

CONCLUSION

Petitioner's wholly owned subsidiary, [redacted] was the Prime Contractor for the [redacted] contract at the [redacted] [redacted] had full authority, management, and [redacted]

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control over the contract. Idaho Code section 63-3027(u) provides that anyone performing management services directly for the United States government must use separate accounting when reporting their taxable income to Idaho. duties to and fulfillment of the contract constitutes management services as contemplated in Idaho Code section 63-3027(u). Therefore, the Tax Commission finds Petitioner is required to report its income from using separate accounting.

The Bureau added interest and penalties to Petitioner’s Idaho tax deficiency. The Tax Commission reviewed those additions and found the interest addition appropriate and in accordance with Idaho Code section 63-3045. However, as for the penalties, the Bureau added the negligence penalty and the substantial understatement penalty to Petitioner’s tax. The Tax Commission found the negligence penalty appropriate but with respect to the substantial understatement penalty, the Tax Commission found Petitioner had reasonable cause and acted in good faith when using the apportionment method versus separate accounting. Therefore, the Tax Commission upholds the negligence penalty and waives the substantial understatement penalty.¹²

THEREFORE, the Notice of Deficiency Determination dated October 15, 2021, and directed to is AFFIRMED as MODIFIED by this decision.

IT IS ORDERED that Petitioner pay the following tax, penalty and interest:

<u>YEAR</u>	<u>REFUND CLAIMED</u>	<u>REFUND ALLOWED</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/2015	(\$258)	(\$258)			(\$55)	(\$313)
12/31/2016	(552,750)		1,048,167	55,408	245,788	1,349,363
12/31/2017			696,527	34,826	104,469	835,822
12/31/2018			1,037,034	51,852	164,789	<u>1,253,675</u>
					TOTAL DUE	<u>\$3,438,547</u>

¹² See Idaho Code section 63-3046(d)(7).

Interest is calculated to August 31, 2023.

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 _____ 2023.

IDAHO STATE TAX COMMISSION

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.
