BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 2-030-588-928
[redacted]	)	
	)	
Petitioner.	)	DECISION
	)	

[redacted] (Petitioner) protested the Notice of Deficiency Determination (Notice) dated December 13, 2024, 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 upholds the Notice.

BACKGROUND

Petitioner is a roaster, marketer, and retailer [redacted] The Multistate Tax Commission (MTC) conducted an audit of Petitioner's Idaho corporate income tax returns for fiscal years ending September 30, 2018, September 29, 2019, and September 27, 2020 (tax years 2017, 2018, and 2019, respectively), to determine if Petitioner's income was fairly apportioned. The MTC concluded that the amount of income Petitioner apportioned to Idaho using cost of performance was incorrect. The MTC provided their findings to the Tax Commission, recommending the Bureau adjust Petitioner's apportionable income, apportionment factor,[1] and Idaho investment tax credit (ITC). The Bureau found the MTC's

[1] The MTC's recommendation is regarding the sales factor (both numerator and denominator) in the apportionment factor. Petitioner did not protest the MTC's sales denominator adjustment; therefore, the Tax Commission will not address it further. Petitioner protested the MTC's sales numerator adjustment.

recommendations applicable to Idaho. The Bureau followed these recommendations, further adjusted[2] Petitioner's apportionable income and sent them a Notice.

Petitioner's representative protested the Notice, disagreeing with the Bureau's inclusion of royalties, i.e., receipts from intangibles, in the sales numerator of their apportionment factor. The representative explained that Petitioner received royalties because of their licensing agreements with [redacted] and argued that none of these royalties should be apportioned to Idaho since the greater costs of performance did not occur in Idaho.[3] However, the MTC concluded that Petitioner's income producing activity associated with the royalties was wholly performed in Idaho when [redacted] sold the [redacted] trademarked products to [redacted] Idaho customers.

In the protest, the representative argued that the MTC's conclusion is more in line with the market-based sourcing method rather than Idaho's costs of performance method. The MTC's report explained their rationale for using the method they choose stating that, generally, the "'costs of performance' standard is applicable to the provision of multistate services; it would be difficult to apply such a standard to licensing intangible income."

The representative continued to disagree with the MTC's conclusion arguing that Petitioner's income producing activity is the licensing of intangibles, i.e., trademarks, which was not wholly performed in Idaho. The representative further argued, since Petitioner's income producing activities occurred within and outside Idaho, apportionment of their royalties must be determined based on costs of performance, and therefore none of the royalties should be apportioned to Idaho as the greater costs of performance did not occur in Idaho. The representative also disagreed with the Bureau's imposition of penalty and requested the Tax Commission abate

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[2] Petitioner did not protest these adjustments; therefore, the Tax Commission will not address them further in this decision.
[3] Idaho's costs of performance method is "all-or-nothing".

it. 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 October 23, 2025. After reviewing the file, the Tax Commission hereby issues its final decision.

ISSUES

There are two issues on appeal. One is the apportionment factor, specifically Petitioner's sales numerator and whether the royalties they received from [redacted]. ([redacted] should be apportioned to Idaho. The other issue is the imposition of the penalty.

LAW AND ANALYSIS

Sales numerator

IDAPA 35.01.01.550. Sales Factor: Sales other than sales of tangible personal property in Idaho, provides,

> **02. Income Producing Activity**. The term income producing activity applies to **each separate item of income** and means the transactions and activity engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of producing that item of income. The activity includes transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. (emphasis added)

IDAPA 35.01.01.550., also provides,

> **04. Application.**[4] In general, receipts, other than from sales of tangible personal property, in respect to a particular income producing activity are in Idaho if:
>
> > **a.** The income producing activity is performed **wholly in Idaho**; **or**
> >
> > **b.** The income producing activity is performed **both within and without Idaho** and a greater part of the income producing activity is performed

[4] Idaho Code section 63-3027(r) Sales, other than sales of tangible property, are in this state, if:
(1) The income-producing activity is performed in this state; or
(2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

> in Idaho than in any other state, **based on costs of performance**. (emphasis added)

And,

> **01. In General**. ...gross receipts are attributed to Idaho if, with respect to a particular item of income, the income producing activity is performed within and without Idaho but **the greater part of the income producing activity is performed in Idaho, based on costs of performance.** (emphasis added)
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> **03. Costs of Performance** Costs of performance are the direct costs determined in a manner consistent with generally accepted accounting principles and according to accepted conditions or practices of the taxpayer's trade or business to perform the income producing activity that gives rise to the particular item of income. Included in the taxpayer's cost of performance are taxpayer's payments to an agent or independent contractor for the performance of personal services and **utilization** of tangible and intangible property that give rise to the particular item of income. (emphasis added)

To determine whether Petitioner's royalties are apportionable to Idaho, the Tax Commission will review the following: (1) each separate income item, and (2) income producing activities for each separate income item everywhere[5] and in Idaho. If the Tax Commission finds that the income producing activities were performed within and outside Idaho, the Tax Commission will then determine (3) amount of direct costs that are traceable to, and associated with, each separate income item earned by performing the income producing activities, (4) where the preponderance of the costs of performance occurred, and (5) whether the preponderance of the costs of performance effectuates an equitable apportionment.

<u>Income item</u>

In 2018, Petitioner formed a global [redacted] alliance with [redacted] and entered into a licensing agreement.[6] As part of the alliance, [redacted] obtained the rights to manufacture, market, sell, and

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[5] Petitioner's filing method was worldwide.

[6] The agreements between [redacted] and Petitioner ([redacted] agreements) are embodied in several separate contracts: the Transaction Agreements, the Master Supply, Distribution and Licensing Agreement, the Initial Supply and Distribution Agreements, the Initial Trademark License Agreements, and the Transition Services Agreement. [redacted]

distribute Petitioner's products in third-party owned retail stores, i.e. Albertsons, WinCo, etc., and online, i.e. Amazon.com, Walmart.com, Target.com, etc. As a result, Petitioner received royalties from [redacted] for the following:

1. Perpetual license
2. Customer contracts
3. Continuing royalty payments
4. Royalties from domestic licensed stores' use of the [redacted] trademark

The representative explained in the protest that, during the years under review, Petitioner received two types of royalty payments: a prepaid upfront royalty payment and a continuing royalty payment.

The prepaid upfront royalty payment is a one-time payment from [redacted] to Petitioner, which is comprised of the perpetual license (income item 1) and the customer contracts (income item 2). In the protest, the representative provided descriptions of the income items,

> The "perpetual license" component represents consideration for the transfer of existing licensing rights that [redacted] developed in the United States over a period of time leading up to the consummation of the [redacted] Agreement.
>
> The "customer contracts" component of the prepaid upfront royalty represents consideration for the transfer of customer contracts held by [redacted] and transferred to [redacted] under the [redacted] Agreement.

The continuing royalty includes the ongoing payments (income item 3) based on the [redacted] Agreement, and the payments from domestic licensed stores' use of the [redacted] trademark

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[redacted] official press release, dated May 7, 2018, says that Petitioner received a $7.15 billion cash payment upfront. The $7.15 billion payment was determined through negotiated valuation[6] rather than a fair market value appraisal and was comprised of $6.82 billion for the perpetual license itself and $330 million for the transfer of certain assets, i.e. customer contracts etc. In subsequent years, Petitioner received the continuing royalty payments based on the licensing agreement. The continuing royalty payment amount was based on a percentage of [redacted] net sales of [redacted] brand products (i.e., packaged [redacted] [redacted] etc.) in licensed channels/territories, and the royalty rate varied by product type. In addition to these royalties, Petitioner received royalty payments from domestic licensed stores' use of the [redacted] trademarks. [redacted] press release also says, "approximately 500 [redacted] employees joined the [redacted] family to drive performance of the existing business and global expansion. Operations will continue to be located in [redacted] (income item 4). The Tax Commission will review the income producing activity for these income items.

Income producing activity

IDAPA 35.01.01.550.02., provides that an income producing activity applies to "each separate item of income", and the Tax Commission must independently analyze "each separate item of income" to determine where the income producing activities, with respect to the particular item of income, took place. The MTC Article IV, Section 17, as originally adopted by Idaho in the 1960s,[7] explains income producing activities are "transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of producing that item of income."

IDAPA 35.01.01.550.02.a., states that income producing activity includes the following,

> iv. The sale, **licensing** or other use **of intangible personal property**. (emphasis added)

Petitioner received royalties when they licensed their trademarks, i.e. intangible personal property, to [redacted] The representative argued in the protest that Petitioner's income producing activity is readily identified as "licensing of intangible personal property", which is the [redacted] trademarks. However, the MTC had a different view and explained it in response to Appeals' request:

> …**the performance of the "income producing activity" with respect to the use of the intangible occurs when a** [redacted] **product is sold by** [redacted] Thus, when [redacted] sells a [redacted] product to a customer in Idaho performance of the agreement is fulfilled and that would be the location of the "income producing

[7] The MTC amended the model regulation in 2015, changing from the costs of performance method to the market-based sourcing method. Idaho adopted the market-based sourcing method for tax years beginning on and after January 1, 2022. The costs of performance method is as recommended by the MTC and as adopted by Idaho in the 1960s, plus the changes in 2009 to add clarification: "or by an agent or independent contractor acting on behalf of the taxpayer" to Idaho Income Tax Administrative Rule IDAPA 35.01.01.550.02.a.i.

> activity" for both the ongoing [redacted] royalty income and the upfront prepaid [redacted] royalty income… (emphasis added)
>
> "Use" of [redacted] trademark refers to the privilege of utilizing the [redacted] trademark and the income producing activity would be the recognition of the trademark and consequent purchase by end point customers…

The MTC concluded that the "use of trademarks" was "performed wholly in Idaho" (IDAPA 35.01.01.550.04.a) when "a [redacted] product is sold by [redacted] [to [redacted] Idaho customers].[8]

Since [redacted] activities are considered an income producing activity of Petitioner, the Tax Commission could find that [redacted] performed these activities within and outside Idaho and therefore the royalty income could be apportioned to Idaho. The MTC explained,

> …when [redacted] sells a [redacted] product to a customer in Idaho[,] performance of the agreement is fulfilled and that would be the location of the "income producing activity" for both the ongoing [redacted] royalty income and the upfront prepaid [redacted] royalty income.

The representative argued that Petitioner performed their income producing activities within and outside Idaho, but since the greater costs of performance did not occur in Idaho then none of Petitioner's royalties should be apportioned to Idaho. The Tax Commission disagrees with the representative's argument and takes the position that Idaho's costs of performance statute does not fairly represent Petitioner's royalty activity in Idaho. Therefore, the Tax Commission chooses to adopt the alternative method of apportionment proposed by the MTC.

<u>Alternative apportionment</u>

Idaho Code section 63-3027(s) states,

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[8] In response to Appeal's request, the representative provided the percentage of [redacted] Consumer Packaged Goods /Food & Beverage sales that were made to [redacted] Idaho customers, and that is 0.1404% for tax year 2018. In **the market-based sourcing method**, this % represents approximately $9 million of royalties that could have been apportioned to Idaho.

> 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.

The Tax Commission recognizes that the market-based sourcing method is not required under Idaho's costs of performance statute but adopts the MTC's position that it is more appropriate as an alternative method to "effectuate an equitable allocation and apportionment of the taxpayer's income" under Idaho Code section 63-3027(s). The Tax Commission determined that the MTC's calculation is the fairest and most reasonable alternative method to calculate the Idaho royalties.[9] Therefore, the Tax Commission upholds the Notice.

Negligence penalty

In the protest, the representative requested abatement of the negligence penalty asserted by the Bureau.

Idaho Code section 63-3046(a) states,

> If any part of any deficiency is due to negligence or disregard of rules but without intent to defraud, five percent (5%) of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected and paid in the same manner as if it were a deficiency.

Tax Administration and Enforcement Rule IDAPA 35.02.01.410.02., further clarifies that, [a] five percent (5%) negligence penalty shall be imposed if the deficiency results from either negligence by the taxpayer or from disregard by the taxpayer or his agent of state or federal tax laws, rules of the Tax Commission, or Treasury Regulations.

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[9] The MTC's market-based sourcing calculation is based on the percentage of the sales of tangible personal properties (TPP) at Petitioner's own retail stores in Idaho to their everywhere TPP sales while the licensing agreement has nothing to do with the TPP sales at Petitioner's own retail shops. The licensing agreement describes the calculation of royalty is based on [redacted] net sales of the [redacted] trademarked products to their customers.

The Bureau's imposition of the negligence penalty is based on their adjustment, including the royalties in the sales numerator based on the market-based sourcing method. Since the Tax Commission upholds the Bureau's adjustment, the Tax Commission also upholds the Bureau's imposition of the negligence penalty as shown on the Notice.

CONCLUSION

The Tax Commission upholds the Notice. The Bureau added penalty[10] and interest to Petitioner's Idaho tax. The Tax Commission reviewed the additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

THEREFORE, the Notice, dated December 13, 2024, and directed to Petitioner, is hereby AFFIRMED by this decision and MADE FINAL.

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
9/30/2018	$7,398	$370	$1,501	$9,269
9/30/2019	128,020	6,401	19,641	154,062
9/30/2020	(283)	0	(47)	(330)
			TOTAL DUE	$163,001

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

DATED this ________ day of _________________________ 2026.

IDAHO STATE TAX COMMISSION

[10] 5% negligence penalty.

CERTIFICATE OF SERVICE

I hereby certify that on this ________ day of ________________________________ 2026, 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:

[redacted]

Receipt No.

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[redacted]