THIS DECISION HAS BEEN APPEALED TO A COURT FOR JUDICIAL REVIEW
14-329 & 14-1893
TAX TYPE: CORPORATE FRANCHISE
DATE SIGNED: 3-18-2016
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION** Appeal Nos. 14-329 & 14-1893 Account No. ##### Tax Type: Corporate Franchise Audit Period: 01/01/09-12/31/12 Judge: Chapman

Presiding:
John L. Valentine, Commission Chair
Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner:	REPRESENTATIVE-1 FOR TAXPAYER, Attorney
	REPRESENTATIVE-2 FOR TAXPAYER, Attorney
	REPRESENTATIVE-3 FOR TAXPAYER, Witness
	REPRESENTATIVE-4 FOR TAXPAYER, Witness
	REPRESENTATIVE-5 FOR TAXPAYER, CPA, Witness
	REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT, Witness
For Respondent:	REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
	REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT, Witness

STATEMENT OF THE CASE

These matters came before the Utah State Tax Commission for a Formal Hearing on June 10, 2015. On April 17, 2015, TAXPAYER ("TAXPAYER" or "taxpayer") submitted a Memorandum Brief in Support of Requested Relief. On May 13, 2015, Auditing Division ("Division") submitted a Formal Hearing Brief. On May 29, 2015, the taxpayer submitted a Reply Memorandum Brief in Response to Auditing Division's Response Memorandum. On July 22, 2015, each party submitted a Post-Hearing Brief. Based upon the

evidence and testimony, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax at issue is Utah corporate franchise tax.

2. The audit period at issue is January 1, 2009 through December 31, 2012 ("Audit Period").

3. On January 6, 2014, the Division issued a Statutory Notice – Corporate Franchise Tax ("First Statutory Notice") to the taxpayer for two years of the Audit Period, specifically for the period January 1, 2010 through December 31, 2011 (the "2010 tax year" and "2011 tax year").[1] In this notice, the Division imposed additional Utah corporate franchise tax in the amount of $$$$$, plus interest (calculated through February 5, 2014)[2] in the amount of $$$$$, for a total assessment of $$$$$. No penalties were assessed.

4. The taxpayer had filed Utah corporate franchise tax returns for the 2010 and 2011 tax years. In the "Explanation of Items" portion of the First Statutory Notice, the Division explained the changes it made for these two years, as follows in pertinent part:

> Interest income and long-term capital gain income claimed as nonbusiness income has been determined to be business income and is restored to the Utah apportionment base pursuant to Utah Code Ann. §59-7-302 through §59-7-320.

5. On January 24, 2014, the taxpayer appealed the assessment imposed for the 2010 and 2011 tax years, and the matter was designated *USTC Appeal No. 14-329*.

6. On September 12, 2014, the Division issued a Statutory Notice – Corporate Franchise Tax ("Second Statutory Notice") to the taxpayer for one of the other two years of the Audit Period, specifically for the period January 1, 2009 through December 31, 2009 (the "2009 tax year").[3] In this notice, the Division imposed additional Utah corporate franchise tax in the amount of $$$$$, penalties totaling $$$$$ (a 10%

1 Respondent's Exhibit 5.
2 Interest continues to accrue while any tax liability remains unpaid.
3 Respondent's Exhibit 6.

failure to timely file penalty and a 10% failure to timely pay penalty), plus interest (calculated through October 12, 2014) in the amount of $$$$$, for a total assessment of $$$$$.

7. On September 12, 2014, the Division issued another Statutory Notice – Corporate Franchise Tax ("Third Statutory Notice") to the taxpayer for the last year of the Audit Period, specifically for the period January 1, 2012 through December 31, 2012 (the "2012 tax year").[4] In this notice, the Division imposed additional Utah corporate franchise tax in the amount of $$$$$, penalties totaling $$$$$ (a 10% failure to timely file penalty and a 10% failure to timely pay penalty), plus interest (calculated through October 12, 2014) in the amount of $$$$$, for a total assessment of $$$$$.

8. The taxpayer did not file Utah corporate franchise tax returns for the 2009 and 2012 tax years. In the "Explanation of Items" portions of the Second and Third Statutory Notices, the Division explained its assessments for these two years, as follows in pertinent part:

> It has been determined that TAXPAYER should have filed a tax return due to its ownership in the operating entity BUSINESS-1. Utah Code Ann. §59-7-701(4) states, "An S corporation having income derived from or connected with Utah sources shall make a return in accordance with Section 59-1-507." Section 59-1-507(2) states, "A pass-through entity having any income derived from or connected with Utah sources shall make a return for the taxable year as prescribed by the commission."[5]
>
> The apportionment fraction and number of Utah corporations doing business in Utah figures were based on the figures in the prior audit for the years 2010-2011.

9. On October 14, 2014, the taxpayer appealed the assessments imposed for the 2009 and 2012 tax years, and the matter was designated *USTC Appeal No. 14-1893*.

10. Both parties agreed to waive an Initial Hearing and proceed directly to a Formal Hearing.

Background of Entities and the Sale Giving Rise to Income at Issue

4 Respondent's Exhibit 7.

5 The notices mistakenly referred to Section 59-1-507 instead of Section 59-10-507 and Subsection 59-1-507(2) instead of Subsection 59-10-507(2).

11. TAXPAYER was originally organized on or about March 28, 2000, under the laws of the State of Utah. It elected S-corporation status. TAXPAYER's registration as a Utah corporation was last renewed on February 7, 2011 and expired on June 26, 2012, because of a "failure to file renewal."[6] TAXPAYER is owned solely by a married couple, NAME-1 and NAME-2 (collectively referred to as the "NAME-1 & 2"), who owned all of the ownership interest in TAXPAYER via separate revocable trusts.[7]

12. The NAME-1 & 2 formed TAXPAYER for estate planning and asset protection purposes after acquiring a 17.47% interest in an entity called BUSINESS-1("BUSINESS-1") on or about April 1, 1999. BUSINESS-1 is a Utah limited liability company engaged in (X) training in CITY-1, Utah.[8]

13. The NAME-1 & 2 initially owned the interest in BUSINESS-1 individually and not via any entity. On December 22, 1999, the NAME-1 & 2 formed BUSINESS-2, a Utah limited liability company ("BUSINESS-2").[9] The NAME-1 & 2 transferred all of their interest in BUSINESS-1 to BUSINESS-2. The NAME-1 & 2 did not contribute any other assets to BUSINESS-2. As a result, holding the interest in BUSINESS-1 is BUSINESS-2's only business activity.[10] Because BUSINESS-1 is a pass-through entity, its tax liability passed through to its members, including BUSINESS-2.

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6 Respondent's Exhibit 2.

7 Petitioner's Exhibit 1.

8 BUSINESS-1 activities specifically include "conducting and providing online (X) and (Y) training, continuing education, and online pre-employment testing services[.]" Respondent's Exhibit 1, p. 1.

9 Respondent's Exhibit 3.

10 The Amended and Restated Articles of Organization of BUSINESS-2 (BUSINESS-2"Articles of Incorporation"), which was executed and filed with the Utah Department of Commerce in April 2000, indicates that the purposes for which BUSINESS-2 is organized are, as follows:

> a) to enter any lawful arrangement for sharing profits, union of interest, reciprocal association or cooperative association, partnership, individual or other legal entity for the carrying on of any business and to enter into any general or limited partnership for the carrying on of any business.
>
> b) [t]o engage in any other lawful business activities for which limited liability companies may be organized pursuant to the Utah Limited Liability Company Act.

Respondent's Exhibit 3.

14. On or about March 28, 2000, the NAME-1 & 2 created TAXPAYER and transferred a 70% interest in BUSINESS-2 to TAXPAYER.[11] TAXPAYER has no assets other than the 70% interest in BUSINESS-2. As a result, holding the interest in BUSINESS-2 is TAXPAYER's only business activity. Because BUSINESS-2 is also a pass-through entity, the tax liability of BUSINESS-1 that passed through to BUSINESS-2 also passed through to TAXPAYER, based on TAXPAYER's 70% ownership percentage in BUSINESS-2.

15. On or about February 25, 2009, BUSINESS-2 sold most of its interest in BUSINESS-1 on an installment basis pursuant to a Reorganization Agreement Among BUSINESS, BUSINESS-1 and the Members of BUSINESS-1("Reorganization Agreement").[12] BUSINESS-2 is one of the BUSINESS-1 members that participated in the Reorganization Agreement. The reorganization resulted in BUSINESS-2 selling a 15.57% interest in BUSINESS-1 on or about February 25, 2009. The sale is considered the sale of intangible property. After the February 25, 2009 sale, BUSINESS-2 retained a 1.9% interest in BUSINESS-1, which was its only asset after this sale.[13]

16. REPRESENTATIVE-5 FOR TAXPAYER testified that when BUSINESS-2 sold the 15.57% interest in BUSINESS-1 on February 25, 2009, the sale was an installment sale. As a result, BUSINESS-2 received a note on which payments were made over a number of years. For this installment sale, REPRESENTATIVE-5 FOR TAXPAYER testified that the taxability of the interest and capital gains arising

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11 Petitioner's Exhibit 1. The remaining 30% interest in BUSINESS-2 was transferred to another entity called BUSINESS-3, which is not at issue in this appeal.

12 Respondent's Exhibit 1. REPRESENTATIVE-3 FOR TAXPAYER signed the Reorganization Agreement as President of BUSINESS-2.

13 REPRESENTATIVE-5 FOR TAXPAYER, CPA, who prepared corporate franchise tax returns for TAXPAYER, indicated that BUSINESS-2 disposed of its remaining 1.9% interest in BUSINESS-1 in December 2011. Neither party provided much information about the disposition of this remaining 1.9% interest, nor indicated what income, if any, arose from that disposition and whether it is part of the income at issue in this appeal. Regardless, no party suggested that for state tax purposes, any income that may have arisen from the December 2011 disposition of the remaining 1.9% interest should be treated any differently from the income that arose from the February 25, 2009 sale of the 15.57% interest.

from the note would be determined on the date of sale (i.e., February 25, 2009), not on the subsequent dates on which the payments were made and reported for tax purposes.

17. REPRESENTATIVE-3 FOR TAXPAYER explained that because he was a minority owner of BUSINESS-1 (through BUSINESS-2), it was not he who decided to sell the 15.57% interest in BUSINESS-1. He indicated that his daughter was more involved than he was in the sale, but stated that she, too, did not make the decision to sell. REPRESENTATIVE-3 FOR TAXPAYER also stated that he did not consult with an attorney prior to BUSINESS-2's 15.57% interest in BUSINESS-1 being sold in February 2009.

Manner in Which TAXPAYER Reported the Income from the 2009 Sale for Tax Purposes

18. REPRESENTATIVE-5 FOR TAXPAYER prepared TAXPAYER's corporate franchise tax returns for 2009, 2010, 2011, and 2012. REPRESENTATIVE-5 FOR TAXPAYER testified that because BUSINESS-2 is a pass-through entity, any income from BUSINESS-2 is reported by TAXPAYER. He further testified that while he considered operating income (or losses) generated by BUSINESS-1 to be ordinary business income (or losses) when passed through to BUSINESS-2 and TAXPAYER, he did not consider the capital gains and interest that arose from BUSINESS-2's sale of the 15.57% interest in BUSINESS-1 to be ordinary business income when passed through to TAXPAYER.

19. REPRESENTATIVE-5 FOR TAXPAYER stated that while ordinary business income that flowed through to TAXPAYER originated at the BUSINESS-1 level, the interest and capital gains that flowed through to TAXPAYER originated at the BUSINESS-2 level. REPRESENTATIVE-5 FOR TAXPAYER admitted that capital gains and interest could be considered ordinary business income if generated as part of an entity's trade or business. However, REPRESENTATIVE-5 FOR TAXPAYER initially testified that when he completed TAXPAYER's corporate franchise tax returns, he considered the capital gains and interest generated from this particular sale to be portfolio or investment income because he understood that

BUSINESS-2 and TAXPAYER were STATE-1 entities whose business was conducted in STATE-1 where the NAME-1 & 2 lived.

20. Later in the hearing, after it had been pointed out that BUSINESS-2 and TAXPAYER had not yet been incorporated in STATE-1 on the February 25, 2009 date of the sale, REPRESENTATIVE-5 FOR TAXPAYER stated that it is the state in which the entity is "managed," not the state in which the entity is incorporated, on the date of sale that is important in determining which state may tax the proceeds of the sale.

21. The 2009, 2010, 2011, and 2012 federal corporate franchise tax returns that REPRESENTATIVE-5 FOR TAXPAYER prepared for TAXPAYER show the following amounts of ordinary business income (or loss), interest income, and net long-term capital gains:

	Ordinary Business Income (or Loss)	Interest Income	Net Long-Term Capital Gains
2009[14]	($$$$$)	$$$$$	$$$$$
2010[15]	$$$$$	$$$$$	$$$$$
2011[16]	$$$$$	$$$$$	$$$$$
2012[17]	$$$$$	$$$$$	$$$$$

22. REPRESENTATIVE-5 FOR TAXPAYER stated that he did not prepare a 2009 Utah corporate franchise tax return for TAXPAYER because he determined that there would be no Utah tax liability for this year. He made this determination after concluding that the interest and capital gains income from the 2009 sale that was paid in 2009 would be portfolio or investment income not subject to Utah taxation and because there was no ordinary business income for this year that would have been subject to Utah taxation.

14 These amounts are shown on TAXPAYER's 2009 federal return. Petitioner's Exhibit 4 and Respondent's Exhibit 8.

15 These amounts are shown on TAXPAYER's 2010 Utah S Corporation Return (Petitioner's Exhibit 5) and 2010 federal return (Respondent's Exhibit 9).

16 These amounts are shown on TAXPAYER's 2011 Utah S Corporation Return (Petitioner's Exhibit 6) and 2011 federal return (Respondent's Exhibit 10).

17 These amounts are shown on TAXPAYER's 2012 federal return. Petitioner's Exhibit 7 and Respondent's Exhibit 11.

23. REPRESENTATIVE-5 FOR TAXPAYER prepared a 2010 Utah corporate franchise tax return for TAXPAYER because BUSINESS-1 had ordinary business income for this year that was apportioned 100% to Utah.[18] On the return, TAXPAYER indicated that it conducted Utah business activity during this year and apportioned 100% of its ordinary business income to Utah. REPRESENTATIVE-5 FOR TAXPAYER indicated that this income was apportioned 100% to Utah based on the sales, payroll, and property factors of BUSINESS-1. On the return, TAXPAYER also identified its "state of commercial domicile" as STATE-1 and that its corporate books and records were maintained in STATE-1. For these reasons and because the interest and capital gains originated at the BUSINESS-2 level (not the BUSINESS-1 level), REPRESENTATIVE-5 FOR TAXPAYER indicated that he reported the interest and capital gains income from the 2009 sale that was paid in 2010 as portfolio or investment income that was not subject to Utah taxation.

24. REPRESENTATIVE-5 FOR TAXPAYER also prepared a 2011 Utah corporate franchise tax return for TAXPAYER because BUSINESS-1 had ordinary business income for this year that was apportioned 100% to Utah.[19] On the return, TAXPAYER again identified its "state of commercial domicile" as STATE-1 and that its corporate books and records were maintained in STATE-1. REPRESENTATIVE-5 FOR TAXPAYER again indicated that he reported the interest and capital gains income from the 2009 sale that was paid in 2011 as portfolio or investment income that was not subject to Utah taxation.

25. REPRESENTATIVE-5 FOR TAXPAYER stated that he did not prepare a 2012 Utah corporate franchise tax return for TAXPAYER because he determined that there would be no Utah tax liability for this year. He stated that he made this determination after concluding that the interest and capital gains income from the 2009 sale that was paid in 2012 would be portfolio or investment income not subject to Utah taxation and because there was no ordinary business income for this year that would have been subject to Utah

18 Petitioner's Exhibit 5.
19 Petitioner's Exhibit 6.

taxation. REPRESENTATIVE-5 FOR TAXPAYER stated that in 2012, BUSINESS-2 did not own any interest in BUSINESS-1.

26. On its federal returns for all four years at issue, TAXPAYER indicated that its "business activity" is business management.[20]

27. The Division determined that the interest and long-term capital gains arising from the sale of BUSINESS-2's interest in BUSINESS-1 were business income that was subject to Utah taxation. As a result, it determined that TAXPAYER improperly determined that this income was portfolio or investment income not subject to Utah taxation, and it assessed Utah tax on the proceeds of the sale.

28. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT, an auditor for the Division, testified that the Division determined that the interest and capital gains income at issue is business income subject to Utah taxation because the only trade or business of BUSINESS-2 was to hold the interest in BUSINESS-1. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT admitted that an entity can hold and sell an asset or investment where the proceeds result in nonbusiness income, but stated that such an asset or investment must be one that is not held in furtherance of the entity's trade or business. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT indicated that because BUSINESS-2 had no business or trade other than holding the interest in BUSINESS-1, the sale of this asset furthered its trade or business and, thus, is business income under the "functional test." REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT testified that if a company holds only one asset, the company's trade or business is the holding and managing of that single asset.

29. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT further testified that because neither BUSINESS-2 nor TAXPAYER has independent apportionment factors, the business income arising from BUSINESS-2's sale of the BUSINESS-1 asset would be apportioned using the same 100% Utah

20 Respondent's Exhibits 8, 9, 10 and 11.

apportionment factors with which TAXPAYER allocated the ordinary business income that flowed through from BUSINESS-1. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT testified that this position is consistent with other decisions the Commission has issued. He specifically referred to *USTC Appeal No. 09-3091* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 10, 2011) and *USTC Appeal No. 11-2285* (Initial Hearing Order Oct. 2, 2013).

30. In the event that the Commission were to find that the interest and capital gains income generated from the 2009 sale is business income, the taxpayer has provided no evidence to show that this income should be allocated to Utah with a different apportionment factor than the 100% apportionment factor it reported on its 2010 and 2011 Utah corporate franchise tax returns.

31. In the event that the Commission were to find that the interest and capital gains income generated from the 2009 sale is nonbusiness income, REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT stated that the income is subject to taxation in the state of "commercial domicile," as defined in UCA §59-7-302. REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT indicates that the income would still be subject to Utah taxation because there is little evidence to suggest that the commercial domicile of BUSINESS-2 and/or TAXPAYER was in STATE-1 on February 25, 2009, which is the date of the sale and which is prior to the dates that these entities were organized in STATE-1.

Actions Taken by the NAME-1 & 2, BUSINESS-2, and TAXPAYER in 2008 and 2009

32. Prior to 2008, it appears that the NAME-1 & 2 had been Utah resident individuals for many years. In 2008, the NAME-1 & 2 took steps to become residents of STATE-1. REPRESENTATIVE-4 FOR TAXPAYER indicated that she and her husband had owned property in STATE-1 since 1995 and that they changed their domicile to STATE-1 in April 2008. REPRESENTATIVE-3 FOR TAXPAYER was unsure when he and his wife moved to STATE-1, but admitted that they continued to own their Utah home after the move to STATE-1. The NAME-1 & 2' Utah home is located at ADDRESS-1 in CITY-2, Utah. Both

REPRESENTATIVE-3 FOR TAXPAYER and REPRESENTATIVE-4 FOR TAXPAYER testified that during 2008, they obtained STATE-1 resident fishing licenses, voted in STATE-1, and registered a motor vehicle in STATE-1. They also obtained STATE-1 driver's licenses. REPRESENTATIVE-4 FOR TAXPAYER testified that she obtained her STATE-1 driver's license in September 2008. REPRESENTATIVE-4 FOR TAXPAYER stated that they became STATE-1 residents sometime in 2008 because they received the STATE-1 resident dividend in 2009 and because a person is eligible to receive the dividend one year after establishing residency.[21] REPRESENTATIVE-4 FOR TAXPAYER further stated that she and REPRESENTATIVE-3 FOR TAXPAYER were STATE-1 residents during the 2009 through 2012 tax years at issue in this appeal.

33. The Division indicated that it is not important to this corporate franchise case whether or not the NAME-1 & 2 became STATE-1 residents in 2008, which may explain why it did not delve into and ask the NAME-1 & 2 questions about all factors that are considered when determining whether a person is a Utah domiciliary or a Utah resident individual. Furthermore, the Division did not indicate that it disagreed with the NAME-1 & 2 claim that they became STATE-1 residents. Accordingly, to whatever extent, if any, it may be relevant in determining TAXPAYER's tax liability, the Commission finds that the NAME-1 & 2 was both STATE-1 residents in 2008 and continued to be STATE-1 residents during the years at issue in this appeal.

34. That being said, however, there is insufficient evidence for the Commission to find that the NAME-1 & 2 were not also Utah resident individuals for 2008 and the years at issue in this appeal. No information was provided at the hearing to know how many days each year the NAME-1 & 2 spent at their STATE-1 home in comparison to the number of days they spent at their Utah home.[22] In addition, while the

21 NAME-2 also stated that they continued to receive the STATE-1 resident dividend until 2015. No explanation was given as to why the NAME-1 & NAME-2 no longer receive this dividend as of 2015.

22 Under Utah law in effect for 2008 and 2009, a person who has established residency outside of Utah may still be considered a Utah resident individual if he or she is present in Utah for 183 or more days of the taxable year and maintains a permanent place of abode in Utah or if he or she is still considered domiciled in

NAME-1 & 2 testified about several factors that are pertinent in determining a person's domicile under Utah law, the limited information they provided is insufficient to know whether or not they were domiciled in Utah for these years.[23]

35. On December 17, 2008, both BUSINESS-2 and TAXPAYER made online changes at the Utah Department of Commerce in regards to their "registered principals."[24] These changes were made after April 2008, when the NAME-1 & 2 claimed to have become STATE-1 residents, but before February 25, 2009, when the sale at issue occurred. For both BUSINESS-2 and TAXPAYER, the December 17, 2008 changes involved changing their "registered agent" from NAME-1 (with an address of ADDRESS-1, CITY-2, UT #####) to BUSINESS-4 (with an address of ADDRESS-2, CITY-3, UT #####).

36. When these December 17, 2008 changes were made, however, BUSINESS-2 and TAXPAYER did not change the ADDRESS-1, CITY-2, Utah ##### address shown on the Utah Department of Commerce records for their other registered principals. On BUSINESS-2's records, TAXPAYER was identified as a "member" and registered principal of BUSINESS-2. Both before and after December 17, 2008, TAXPAYER's address on BUSINESS-2's records was listed as ADDRESS-1, CITY-2, Utah #####.[25] It is noted that TAXPAYER's address was not changed to reflect an STATE-1 address, even though the December

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Utah. *See* Utah Code Ann. §59-10-103(1)(q)(i) (2008). Effective for 2010 and subsequent tax years, the word "permanent" was removed from the "permanent place of abode" portion of the subsection. *See* Utah Code Ann. §59-10-103(1)(q)(i)(B) (2010).

23 Prior to the 2012 tax year, Utah Admin. Rule R865-9I-2 (2009) and Utah Admin. Rule R884-24P-52 (2009) were used to determine whether or not a person is "domiciled" in Utah. These rules provide that many other criteria that were not discussed at the hearing should also be considered when determining whether a person is domiciled in Utah. Beginning with the 2012 tax year, a different set of criteria are considered when determining whether a person is domiciled in Utah, as found in Utah Code Ann. §59-10-136 (2012). For example, Subsection 59-10-136(2)(a) provides that there is a rebuttable presumption that a person is domiciled in Utah for a taxable year in which he or she claims a primary residential exemption from property taxes for a Utah home. No information was provided to know whether the NAME-1 & NAME-2 continued to receive the primary residential exemption on their Utah home after becoming STATE-1 residents in 2008.

24 Respondent's Exhibit 2 (TAXPAYER) and Respondent's Exhibit 3 (BUSINESS-2).

25 Respondent's Exhibit 3.

17, 2008 change that was made to BUSINESS-2's registered principals occurred after the NAME-1 & 2 claim to have become STATE-1 residents.

37. Furthermore, on TAXPAYER's Utah Department of Commerce records, both REPRESENTATIVE-3 FOR TAXPAYER and REPRESENTATIVE-4 FOR TAXPAYER were identified as "directors" and registered principals, while REPRESENTATIVE-4 FOR TAXPAYER was also identified as TAXPAYER's "vice president." Both before and after the December 17, 2008 change, the address for both of the NAME-1 & 2 was listed as ADDRESS-1, CITY-2, Utah #####, which is their Utah home address.[26] It is noted that neither of the NAME-1 & 2' addresses were changed to reflect their STATE-1 address, even though the December 17, 2008 change that was made to TAXPAYER's registered principals occurred after the NAME-1 & 2 claim to have become STATE-1 residents.

38. REPRESENTATIVE-3 FOR TAXPAYER stated he did not engage in any day-to-day decisions concerning BUSINESS-2 and TAXPAYER. In fact, he characterized his activities with the entities as minimal and stated that TAXPAYER has no business at all.

39. After the February 25, 2009 date that BUSINESS-2 sold the 15.57% interest in BUSINESS-1, steps were taken to create separate TAXPAYER and BUSINESS-2 entities in STATE-1 and to merge the STATE-1 entities with the Utah entities of the same name.

40. On March 18, 2009, both of the NAME-1 & 2 signed an Articles of Merger of TAXPAYER, a Utah Corporation, with and into TAXPAYER and STATE-1 Corporation ("TAXPAYER Articles of Merger"). The TAXPAYER Articles of Merger was filed with the State of STATE-1 Department of Commerce on June 15, 2009.[27] On the basis of these dates, the TAXPAYER Articles of Merger had not been executed when BUSINESS-2 sold the 15.57% interest in BUSINESS-1 on February 25, 2009. To distinguish between the two

26 Respondent's Exhibit 2.
27 Petitioner's Exhibit 2.

TAXPAYER entities wherever needed throughout the remainder of this decision, TAXPAYER, a Utah Corporation, will be referred to as "TAXPAYER" or "TAXPAYER Utah," and TAXPAYER, a STATE-1 Corporation, will be referred to as "TAXPAYER STATE-1."

41. Paragraphs 4 and 6 of the TAXPAYER Articles of Merger provide that the entity surviving after the merger is TAXPAYER STATE-1 and that its principal place of business will be ADDRESS-3, CITY-4, STATE-1 #####. Paragraph 8 of the document provides that the surviving entity's registered agent is NAME-1 and that his address is also ADDRESS-3, CITY-4, STATE-1 #####.

42. Paragraph 2 of the TAXPAYER Articles of Merger indicates that TAXPAYER STATE-1's Articles of Incorporation was filed "with the STATE-1 Secretary of State, Corporations Division, dated March 31, 2009." No evidence was submitted to show that TAXPAYER STATE-1 was created before this March 31, 2009 date or before the March 18, 2009 date on which the TAXPAYER Articles of Merger was executed. Accordingly, TAXPAYER STATE-1 did not exist on the February 25, 2009 date that BUSINESS-2 sold the 15.57% interest in BUSINESS-1. Only TAXPAYER Utah existed on the date of the sale.

43. Furthermore, Paragraph 3 of the TAXPAYER Articles of Merger indicates that each of the parties to the merger have signed an Agreement and Plan of Merger, "dated effective as of the 18th day of March 2009[,]" and that a copy of the plan of merger is attached as Exhibit A. Exhibit A contains the Agreement and Plan of Merger ("TAXPAYER Agreement and Plan of Merger"), but it does not show that TAXPAYER Utah and TAXPAYER STATE-1 entered into it on March 18, 2009. It shows that the two entities entered into it on December 31, 2009.[28] Accordingly, the TAXPAYER Agreement and Plan of Merger also did not exist on the February 25, 2009 date that BUSINESS-2 sold the 15.57% interest in BUSINESS-1.

44. Also on March 18, 2009, REPRESENTATIVE-3 FOR TAXPAYER signed an Articles of Merger of BUSINESS-2, a Utah Limited Liability Company, and BUSINESS-2, a STATE-1 Limited Liability

28 Petitioner's Exhibit 2 and Petitioner's Exhibit 3.

Company ("BUSINESS-2 Articles of Merger").[29] The BUSINESS-2 Articles of Merger was filed with the State of STATE-1 Department of Commerce on June 26, 2009.[30] On the basis of these dates, the BUSINESS-2 Articles of Merger had not yet been executed when the 15.57% interest in BUSINESS-1 was sold on February 25, 2009. To distinguish between the two BUSINESS-2 entities wherever needed throughout the remainder of this decision, BUSINESS-2, a Utah Limited Liability Company, will be referred to as "BUSINESS-2" or "BUSINESS-2 Utah," and BUSINESS-2, a STATE-1 Limited Liability Company, will be referred to as "BUSINESS-2 STATE-1."

45. Paragraphs 4 and 6 of the BUSINESS-2 Articles of Merger provide that the entity surviving after the merger is BUSINESS-2 STATE-1 and that its principal place of business will be ADDRESS-3, CITY-4, STATE-1. Paragraph 8 of the document provides that the surviving entity's registered agent is NAME-1 and that his address is also ADDRESS-3, CITY-4, STATE-1.

46. Paragraph 2 of the BUSINESS-2 Articles of Merger indicates that BUSINESS-2 STATE-1's Articles of Incorporation were filed "with the STATE-1 Secretary of State, Corporations Division, on the 31st day of March, 2009." No evidence was submitted to show that BUSINESS-2 STATE-1 was created before this March 31, 2009 date or before the March 18, 2009 date on which the BUSINESS-2 Articles of Merger was executed. Accordingly, BUSINESS-2 STATE-1 did not exist on the February 25, 2009 date that

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29 Although it appears that REPRESENTATIVE-3 FOR TAXPAYER signed the BUSINESS-2 Articles of Merger on March 18, 2009, a date of March 31, 2009 is typed under the document title. Petitioner's Exhibit 2.

Attached to the BUSINESS-2 Articles of Merger is a page titled "Mailing Address," in which "the Secretary of State or Division" is instructed to send a copy of the BUSINESS-2 Articles of Merger (if it elects to send a copy upon completion of filing) to:

BUSINESS-2
c/o REPRESENTATIVE-2 FOR TAXPAYER
NAME OF LAW FIRM
LAW FIRM ADDRESS
CITY-3, Utah

30 Petitioner's Exhibit 2.

BUSINESS-2 sold the 15.57% interest in BUSINESS-1. Only BUSINESS-2 Utah existed on the date of the sale.

47. Furthermore, Paragraph 3 of the BUSINESS-2 Articles of Merger indicates that each of the parties to the merger have signed an Agreement and Plan of Merger, "dated effective as of the 18th day of March 2009[,]" and that a copy of the plan of merger is attached as Exhibit A. Exhibit A contains the Agreement and Plan of Merger ("BUSINESS-2 Agreement and Plan of Merger") and shows that BUSINESS-2 Utah and BUSINESS-2 STATE-1 did indeed enter into this agreement on March 18, 2009.[31] However, the BUSINESS-2 Agreement and Plan of Merger did not exist on the February 25, 2009 date that BUSINESS-2 sold the 15.57% interest in BUSINESS-1. Accordingly, it is BUSINESS-2 Utah that sold the 15.57% interest in BUSINESS-1 at issue in this appeal. In addition, on the date BUSINESS-2 Utah sold its BUSINESS-1 interest, any tax liability was passed through to BUSINESS-2 Utah's members, which at the time of sale included TAXPAYER Utah, not TAXPAYER STATE-1.

48. Even after TAXPAYER Utah and BUSINESS-2 Utah may have been merged into their STATE-1 counterparts (which would be no sooner than March 18, 2009), TAXPAYER Utah and BUSINESS-2 Utah continued to have their registrations renewed at the Utah Department of Commerce. As already mentioned, BUSINESS-2 Utah's registration was last renewed on December 22, 2011 and did not expire until March 25, 2013.[32] In addition, TAXPAYER Utah's registration was last renewed on February 7, 2011 and did not expire until June 26, 2012.[33]

49. REPRESENTATIVE-3 FOR TAXPAYER testified that he was not aware that TAXPAYER Utah and BUSINESS-2 Utah continued to be registered as Utah domestic entities. He stated that he assumed that TAXPAYER Utah had ceased to exist when the TAXPAYER Articles of Merger was filed on June 15,

31 Petitioner's Exhibit 2 and Petitioner's Exhibit 3.
32 Respondent's Exhibit 3.
33 Respondent's Exhibit 2.

2009, and that BUSINESS-2 Utah had ceased to exist when the BUSINESS-2 Articles of Merger was filed on June 26, 2009. REPRESENTATIVE-3 FOR TAXPAYER clarified that it was not he who continued to register BUSINESS-2 Utah and TAXPAYER Utah with the Utah Department of Commerce in 2009 and subsequent years.

50. There is little, if any, evidence to suggest that the principal place from which the trade or business of BUSINESS-2 and/or TAXPAYER was directed or managed on or prior to February 25, 2009, is STATE-1 and not Utah. While the NAME-1 & 2 may have become STATE-1 residents in 2008, this alone does not show that either of them directed or managed BUSINESS-2 and/or TAXPAYER while in STATE-1 on or prior to the February 25, 2009 sale. Either or both of them could have as easily directed or managed the entities from their home in Utah as opposed to their home in STATE-1. In addition, the evidence does not show that it was even the NAME-1 & 2 who directed or managed these entities on or prior to February 25, 2009. REPRESENTATIVE-4 FOR TAXPAYER did not indicate that she directed or managed the entities. Furthermore, REPRESENTATIVE-3 FOR TAXPAYER stated he did not engage in any day-to-day decisions concerning BUSINESS-2 and TAXPAYER. In fact, he characterized his activities with the entities as minimal.

51. Prior to the February 25, 2009 date of sale, the last evidence of some action being taken in regards to the direction or management of BUSINESS-2 and TAXPAYER occurred on December 17, 2008, when the registered agents of both entities were changed to BUSINESS-4 (which has a Utah address). In addition, whoever changed the registered agents of BUSINESS-2 and TAXPAYER at the Utah Department of Commerce in December 2008 apparently saw no need to change the Utah addresses of the entities' other registered principals, which included both of the NAME-1 & 2. They also saw no need to change the Utah address of TAXPAYER, which was listed as one of BUSINESS-2's members. This information suggests that

on February 25, 2009, BUSINESS-2 and/or TAXPAYER were still being directed or managed primarily in Utah, not STATE-1. The taxpayer has not met its burden of proof to show that BUSINESS-2 and/or TAXPAYER were being directed or managed primarily from STATE-1 on the February 25, 2009 date of sale. Furthermore, the taxpayer has provided no information to show that BUSINESS-2 and/or TAXPAYER were doing business in a state other than Utah on or prior to the February 25, 2009 date of sale.

APPLICABLE LAW[34]

1. Utah's Uniform Division of Income for Tax Purposes Act ("UDITPA") provisions are set forth in Title 59, Chapter 7, Part 3 of the Utah Code. UCA §59-7-303 provides for the allocation and apportionment of income, as follows:

> (1) Any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion its adjusted income as provided in this part.
> (2) Any taxpayer having income solely from business activity taxable within this state shall allocate or apportion its entire adjusted income to this state.

2. For purposes of the UDITPA provisions, UCA §59-7-302[35] defines "business income," "commercial domicile," "nonbusiness income," and "sales," as follows in pertinent part:

> . . . .
> (4) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.
> (5) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.
> . . . .
> (8) "Nonbusiness income" means all income other than business income.
> (10) "Sales" means all gross receipts of the taxpayer not allocated under Sections 59-7-306 through 59-7-310.
> . . . .

34 The 2009 version of Utah law is cited, unless otherwise indicated.

35 Subsequent to 2009, Section 59-7-302 has been renumbered and amended. The definitions of "business income," "commercial domicile," "nonbusiness income," and "sales," were renumbered, but were not amended.

3. UCA §59-7-311[36] provides the method with which "business income" is apportioned to Utah, as follows in pertinent part:

> (1) All business income shall be apportioned to this state by multiplying the business income by a fraction calculated as provided in Subsection (2).
> (2) The fraction described in Subsection (1) is calculated as follows:
> (a) for a taxpayer that does not make an election authorized by Subsection (3):
> (i) the numerator of the fraction is the sum of:
> (A) the property factor as calculated under Section 59-7-312;
> (B) the payroll factor as calculated under Section 59-7-315; and
> (C) the sales factor as calculated under Section 59-7-317; and
> (ii) the denominator of the fraction is three; and
> (b) for a taxpayer that makes an election authorized by Subsection (3):
> (i) the numerator of the fraction is the sum of:
> (A) the property factor as calculated under Section 59-7-312;
> (B) the payroll factor as calculated under Section 59-7-315; and
> (C) the product of:
> (I) the sales factor as calculated under Section 59-7-317; and
> (II) two; and
> (ii) the denominator of the fraction is four.
> . . . .

4. UCA §59-7-317 provides that "[t]he sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period."

5. As to the allocation of "nonbusiness income," UCA §59-7-306 provides that "[r]ents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in Sections 59-7-307 through 59-7-310."

6. UCA §59-7-308 provides that "[t]o the extent that the following constitute nonbusiness income: . . . (3) capital gains and losses from sales of intangible personal property are allocable to this state if

36 Subsections 59-7-311(1) and (2) were amended in 2010 when Utah's corporate franchise and income tax laws were amended to provide for a "sales factor weighted taxpayer." Neither party, however, indicates that these 2010 amendments have any effect on this case.

the taxpayer's commercial domicile is in this state."

7. UCA §59-7-309 provides that "[t]o the extent they constitute nonbusiness income, interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state."

8. UCA §59-7-305provides that a taxpayer is taxable in another state for purposes of allocation and apportionment, as follows in pertinent part:

> For purposes of allocation and apportionment of income under this part, a taxpayer is taxable in another state if:
>
> . . . .
>
> (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

9. The Commission has enacted Utah Admin. Rule R865-6F-8 ("Rule 8")[37] to provide guidance concerning "business income" and "nonbusiness income" and how to allocate or apportion that income to Utah, as follows in pertinent part:

> (1) Definitions.
>
> (a) "Allocation" means the assignment of nonbusiness income to a particular state.
>
> (b) "Apportionment" means the division of business income between states by the use of a formula containing apportionment factors.
>
> . . . .
>
> (d) "Business activity" refers to the transactions and activities occurring in the regular course of a particular trade or business of a taxpayer, or to the acquisition, management, and disposition of property that constitute integral parts of the taxpayer's regular trade or business operations.
>
> (e) "Business income" means income of any type or class, and from any activity, that meets the relationship described in Subsection (2)(b), the transactional test, or Subsection (2)(c), the functional test. The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, and nonoperating income is of no aid in determining whether income is business or nonbusiness income.
>
> . . . .
>
> (i) "Nonbusiness income" means all income other than business income.
>
> . . . .
>
> (2) Business and Nonbusiness Income.
>
> (a) Apportionment and Allocation. Section 59-7-303 requires that every item of income

37 Rule 8 has been amended since 2009. Any amendment to a subsection included in the applicable law will be identified. However, it is noted that neither party indicated that any such amendment has an effect on the outcome of this case.

be classified as either business income or nonbusiness income. Income for purposes of classification as business or nonbusiness includes gains and losses. Business income is apportioned among jurisdictions by use of a formula. Nonbusiness income is specifically assigned or allocated to one or more specific jurisdictions pursuant to express rules. An item of income is classified as business income if it falls within the definition of business income. An item of income is nonbusiness income only if it does not meet the definitional requirements for being classified as business income.

(b) Transactional Test. Business income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business.

. . . .

(c) Functional Test. Business income also includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(i) The following definitions apply to this Subsection (2)(c).

(A) "Acquisition" means the act of obtaining an interest in property.

(B) "Disposition" means the act, or the power, of relinquishing or transferring an interest in or control over property to another, either in whole or in part.

(C) "Integral part" means property that constitutes a part of the composite whole of the trade or business, each part of which gives value to every other part, in a manner that materially contributes to the production of business income.

(D) "Management" means the oversight, direction, or control, whether directly or by delegation, of the property for the use or benefit of the trade or business.

. . . .

(ii) Under the functional test, business income need not be derived from transactions or activities that are in the regular course of the taxpayer's own particular trade or business. It is sufficient, if the property from which the income is derived is or was an integral, functional, or operative component used in the taxpayer's trade or business operations, or otherwise materially contributed to the production of business income of the trade or business, part of which trade or business is or was conducted within the state. . . .

(iii) Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers, or transactions involving property, including transactions made in liquidation or the winding-up of business, is business income if the property is or was used in the taxpayer's trade or business operations. . . .

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

. . . .

(vii) Application of the functional test is generally unaffected by the form of the property, whether tangible or intangible, real or personal. Income arising from an intangible interest, for example, corporate stock or other intangible interest in a business or a group of assets, is business income when the intangible itself or the property underlying or associated with the intangible is or was an integral, functional, or operative component of the taxpayer's trade or business operations.

. . . .

(B) While apportionment of income derived from transactions involving intangible property as business income may be supported by a finding that the issuer of the intangible property and the taxpayer are engaged in the same trade or business, that is, the same unitary business, establishment of that relationship is not the exclusive basis for concluding that the income is subject to apportionment.

(C) It is sufficient to support the finding of apportionable income if the holding of the intangible interest served an operational rather than an investment function of mere financial betterment.

. . . .

(e) Business and Nonbusiness Income Application of Definitions.

. . . .

(ii) Gains or Losses From Sales of Assets. Gain or loss from the sale, exchange, or other disposition of real property or of tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in, or was otherwise included in the property factor of the taxpayer's trade or business. However, if the property was utilized for the production of nonbusiness income or it was previously included in the property factor and later removed from the property factor before its sale, exchange, or other disposition, the gain or loss constitutes nonbusiness income. See Subsection (8)(a)(ii).

(iii) Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations, or where the purpose for acquiring and holding the intangible is an integral, functional, or operative component of the taxpayer's trade or business operations, or otherwise materially contributes to the production of business income of the trade or business operations.

. . . .

(4) Apportionment and Allocation.

(a) (i) If the business activity with respect to the trade or business of a taxpayer occurs both within and without this state, and if by reason of that business activity the taxpayer is taxable in another state, the portion of the net income (or net loss) arising from the trade or business derived from sources within this state shall be determined by apportionment in accordance with Sections 59-7-311 to 59-7-319.

(ii) For purposes of determining the fraction by which business income shall be apportioned to this state under Section 59-7-311: . . . [38]

38 Subsequent to 2009, the provisions found in Rule 8(4)(a)(ii) were amended, in part, to address a "sales factor weighted taxpayer." Neither party, however, indicates that any amendments subsequent to 2009 have an effect on the outcome of this case.

> (b) Allocation. Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonbusiness income or loss within or without this state in accordance with Sections 59-7-306 to 59-7-310.
>
> . . . .
>
> (7) Apportionment Formula. All business income of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in Section 59-7-311. The elements of the apportionment formula are the property factor, see Subsection (8), the payroll factor, see Subsection (9), and the sales factor, see Subsection (10) of the trade or business of the taxpayer. For exceptions see Subsection (11).
>
> . . . .
>
> (11) Special Rules:
>
> . . . .
>
> (e)[39] Partnership or Joint Venture Income. Income or loss from partnership or joint venture interests shall be included in income and apportioned to Utah through application of the three-factor formula consisting of property, payroll and sales. For apportionment purposes, the portion of partnership or joint venture property, payroll and sales to be included in the corporation's property, payroll and sales factors shall be computed on the basis of the corporation's ownership interest in the partnership or joint venture, and otherwise in accordance with other applicable provisions of this rule.

10. UCA §59-1-1417(1) (2015) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

> (1) In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:
>
> (a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
>
> (b) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
>
> (c) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income:
>
> (i) required to be reported; and
>
> (ii) of which the commission has no notice at the time the commission mails the notice of deficiency.

DISCUSSION

39 In 2011, this provision was renumbered.

The first issue to be addressed is whether the interest and capital gains income passed through to TAXPAYER from BUSINESS-2's sale of its interest in BUSINESS-1 is business income or nonbusiness income.[40] If the Commission finds that the income at issue is business income, as the Division contends, the Commission must next determine whether the taxpayer has shown that the same 100% apportionment factor with which it apportioned ordinary business income from BUSINESS-1 to Utah should not also be used to apportion the interest and capital gains income to Utah. On the other hand, if the Commission finds that the income at issue is nonbusiness income, as the taxpayer contends, the Commission must then determine whether that income is allocable to Utah.

Business Income or Nonbusiness Income. Utah's UDITPA provisions are used to determine the amount of income that a corporate franchise or income taxpayer should apportion and/or allocate to Utah. These provisions are found at UCA §§59-7-302 through 59-7-321. The provisions divide income into two separate categories, business income and nonbusiness income. Business income is generally apportioned to each state through the use of a formula that is based on the taxpayer's property, payroll, and sales. Nonbusiness income is generally allocated to the state in which the taxpayer's commercial domicile is located. Subsection 59-7-302(4) defines "business income," as follows:

> "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

Subsection 59-7-302(8) provides that "nonbusiness income" means "all income other than business income."

40 It is noted that the income generated by BUSINESS-2 sale on its interest in BUSINESS-1 is attributable to TAXPAYER as if TAXPAYER had sold the BUSINESS-1 interest itself, pursuant to either UCA §59-10-1404 or Internal Revenue Code §1366(b). (It is unclear which of these provisions is applicable to this case because of ambiguity concerning the applicability of UCA §59-7-701(1) to an S corporation for the years at issue.)

The Commission has consistently found that business income includes income that satisfies either of two tests commonly referred to as the transactional test and the functional test.[41] Moreover, "business income" is further defined in Rule 8(1)(e) to mean income of any type or class and from any activity that meets the transactional test or the functional test. The transactional test, as set forth in Rule 8(2)(b), includes "income arising from transactions and activity in the regular course of the taxpayer's trade or business." The functional test, as set forth in Rule 8(2)(c), includes "income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." The Commission has determined that to qualify as business income, the income at issue need only meet one of the two tests, an interpretation supported by cases in other jurisdictions with a similar definition of "business income."[42] The Division did not rely on the transactional test to assert that the interest and capital gains income at issue in this appeal is business income.[43] As a result, the Commission will limit its analysis to whether the income is business income under the functional test.

The taxpayer argues the interest and capital gains income resulting from BUSINESS-2's sale of its interest in BUSINESS-1 is investment or portfolio income that is not business income. Rule 8(1)(e), however, provides, in part, that:

> The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, and nonoperating income is of no aid in determining whether income is business or nonbusiness income.

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41 *See USTC Appeal No. 04-0970* (Findings of Fact, Conclusions of Law, and Final Decision Dec. 11, 2008); *USTC Appeal No. 01-0005* (Findings of Fact, Conclusions of Law, and Final Decision Nov. 1, 2002); and *USTC Appeal No. 97-1416* (Order Apr. 29, 1999). Redacted copies of these and other selected decisions can be viewed on the Commission's website at http://www.tax.utah.gov/commission-office/decisions.

42 *See Polaroid v. Offerman*, 507 S.E.2d 284 (N.C. 1998); *Hoechst Celanese Corp. v. Franchise Tax Board*, 22 P.3d 324 (Cal. 2001).

43 The Division relied on the functional test to support its position that the income at issue is business income. It is noted, however, that REPRESENTATIVE-6 FOR TAXPAYER & RESPONDENT testified that he would not concede that the income at issue is not also business income under the transactional test.

Accordingly, even if the income at issue is investment or portfolio income, that label may not be useful in determining whether it is business income or nonbusiness income.

The taxpayer offered other reasons as to why it believes that the income at issue does not meet the functional test. The taxpayer argues that BUSINESS-2 and/or TAXPAYER are holding companies that do not have a regular trade or business and that the NAME-1 & 2 acquired the asset (i.e., the interest in BUSINESS-1) merely for their financial betterment and intended it only to be an investment. The taxpayer points out that the NAME-1 & 2 transferred ownership of the asset to a holding company, BUSINESS-2, for estate planning purposes. The taxpayer contends that because BUSINESS-2 and/or TAXPAYER are holding companies without a trade or business and because BUSINESS-2 holds a single asset that was acquired merely as an investment, the income generated from the sale of that asset does not meet the functional test pursuant to Rule 8(2)(c)(iv), which, in part, provides that:

> The functional test is not satisfied where the holding of the property is limited to solely an investment function as is the case where the holding of the property is limited to mere financial betterment of the taxpayer in general.

Key to this particular sentence of Rule 8(2)(c)(iv) is the word "limited." Assume, for example, that a taxpayer purchases a government security as an investment for its financial betterment. Income generated from that asset could be considered business income or nonbusiness income, depending on the circumstances. For a taxpayer that is regularly engaged in the manufacturing trade or business and who uses excess cash to purchase the government security to generate additional revenue, holding the government security may be limited to the mere financial betterment of the taxpayer in general. For a taxpayer that is regularly engaged in the business of managing securities, however, holding the government security may not be limited to the mere financial betterment of the taxpayer in general. For this latter taxpayer, holding the governmental security asset may also serve its regular trade or business. Most assets are purchased for the financial betterment of their owners.

Before the income generated by that asset can be classified as business income or nonbusiness income, however, it must be determined whether the asset is limited to the mere financial betterment of the taxpayer in general or whether it is also "an integral, functional, or operative component used in the taxpayer's trade or business operations, or otherwise materially contributed to the production of business income of the trade or business," as set forth in Rule 8(2)(c)(ii). Accordingly, the NAME-1 & 2' purchase of the BUSINESS-1 interest as an investment before transferring it to a holding company is not determinative in deciding whether the sale of that asset generates business income or nonbusiness income for the taxpayer.

The taxpayer contends that BUSINESS-2 and/or TAXPAYER have no business activity because they have no regular trade or business operations. As a result, it contends that holding a single asset (i.e, the BUSINESS-1 interest) must be limited to the mere financial betterment of BUSINESS-2 and/or TAXPAYER. The facts, however, indicate that BUSINESS-2 and/or TAXPAYER do have a regular trade or business. BUSINESS-2, and through it TAXPAYER, held an interest in a Utah operating company (i.e., BUSINESS-1) for many years prior to the 2009 sale. In addition, BUSINESS-2's Articles of Incorporation indicate, in part, that it was created "for the carrying on of any business" and to engage in lawful "business activities for which limited liability companies may be organized[.]" TAXPAYER retained an accountant to handle the federal and state tax liabilities associated with the income and losses that were passed through to BUSINESS-2 and TAXPAYER because of this ownership interest. BUSINESS-2 and TAXPAYER had registered agents, officers, and directors and, in December 2008, even designated BUSINESS-4 to be their registered agent to receive official notifications for these businesses. Furthermore, BUSINESS-2 participated in the sale of the BUSINESS-1 interest, as shown in the Reorganization Agreement that gave rise to the income at issue in this appeal. These activities indicate that BUSINESS-2 and/or TAXPAYER were operating a trade or business to manage the BUSINESS-1 asset that was generating income for TAXPAYER for many years.

Admittedly, the BUSINESS-1 asset that generated the income at issue was contributed to BUSINESS-2. Nevertheless, BUSINESS-2 "obtained" the asset.[44] Furthermore, since 2000, TAXPAYER has been organized to "manage" the asset.[45] For all years at issue, TAXPAYER reported to the federal government that its "business activity" was business management. BUSINESS-2, and through it TAXPAYER, managed the BUSINESS-1 interest that had been contributed to BUSINESS-2. BUSINESS-2 and TAXPAYER both had registered agents, directors, and officers registered with the Utah Department of Commerce to accomplish this management. Although the NAME-1 & 2 themselves may not have performed all of the oversight, direction, or control duties for these entities, it appears that they retained accountants, registered agents, and attorneys[46] to assist in or to delegate these duties. BUSINESS-2 also "disposed" most of its BUSINESS-1 interest when it entered into the Reorganization Agreement on February 25, 2009.[47]

Furthermore, the interest in BUSINESS-1 was an "integral part" of TAXPAYER's trade or business through BUSINESS-2 and materially contributed to the production of business income for TAXPAYER.[48] Not only was the interest in BUSINESS-1 the composite whole of BUSINESS-2's and/or TAXPAYER's trade or business, but it also contributed to the production of business income. The BUSINESS-1 interest is the only

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44 "Acquisition" is defined in Rule 8(2)(c)(i)(A) to mean "the act of obtaining an interest in property." *Black's Law Dictionary* 972 (5th ed. 1979) defines "obtain" to mean "to get hold of by effort; to get possession of; to procure; to acquire, in any way." These definitions do not indicate that an entity must purchase an item before that entity is considered to have acquired it. One can acquire an item through a contribution.

45 "Management" is defined in Rule 8(2)(c)(i)(D) to mean "the oversight, direction, or control, whether directly or by delegation, of the property for the use or benefit of the trade or business."

46 Several months after the February 25, 2009 sale at issue, BUSINESS-2 STATE-1 submitted the BUSINESS-2 Articles of Merger to register with the State of STATE-1 Department of Commerce. Attached to the documents submitted to STATE-1 was a page titled "Mailing Address," in which "the Secretary of State or Division" was instructed to send a copy of the BUSINESS-2 Articles of Merger (if it elects to send a copy upon completion of filing) to BUSINESS-2, c/o REPRESENTATIVE-2 FOR TAXPAYER, at the NAME OF LAW FIRM law firm in CITY-3, Utah.

47 "Disposition" is defined in Rule 8(2)(c)(i)(B) to mean "the act, or the power, of relinquishing or transferring an interest in or control over property to another, either in whole or in part."

48 "Integral part" is defined in Rule 8(2)(c)(i)(C) to mean "property that constitutes a part of the composite whole of the trade or business, each part of which gives value to every other part, in a manner that materially contributes to the production of business income."

asset that BUSINESS-2 and/or TAXPAYER acquired, managed and ultimately disposed of and, thus, was an integral, functional, or operative component used in BUSINESS-2's and/or TAXPAYER's trade or business. Furthermore, the asset contributed to the production of business income of the trade or business. Accordingly, the interest and capital gains income at issue meets the functional test, as described in Rule 8(2)(c)(ii), and is business income.

This conclusion is further supported by Rule 8(2)(c)(iii), which, in part, provides that:

> Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers, or transactions involving property, including transactions made in liquidation or the winding-up of business, is business income if the property is or was used in the taxpayer's trade or business operations.

Although BUSINESS-2 had not sold any of its interest in BUSINESS-1 prior to February 25, 2009, this isolated or infrequent sale does not prevent the income generated from the sale from being classified as business income under the functional test. The property (i.e., the BUSINESS-1 asset) was used for years in BUSINESS-2's and/or TAXPAYER's trade or business operations to generate the ordinary business income that was completely apportioned to Utah. As a result, the income from its sale or liquidation is also business income.

Based on the foregoing, the BUSINESS-1 interest was not held merely for the financial betterment of BUSINESS-2 and/or TAXPAYER in general. It also served the trade or business for which BUSINESS-2 and/or TAXPAYER were created, specifically to hold and manage this asset. As a result, the taxpayer's argument that the functional test is not satisfied pursuant to Rule 8(2)(c)(iv) is unpersuasive. Because the acquisition, management, and disposition of the BUSINESS-1 interest constitutes an integral part of BUSINESS-2's and/or TAXPAYER's regular trade or business operations, the interest and capital gains income at issue meets the functional test, as described in Rule 8(2)(c), and is business income.

The taxpayer contends that such a conclusion would, by default, result in all income being classified as business income (i.e., result in no income being classified as nonbusiness income). The taxpayer contends that such a result would be improper because it would render the rules and definitions outlined in Utah law meaningless, as no income could possibly escape classification as business income. While such an outcome would indeed be improper, the Commission disagrees with the taxpayer's position that no income can be classified as nonbusiness income if the income at issue in this case is found to be business income. The Commission has explained earlier how income generated by the same asset can be either business income or nonbusiness income, depending upon the owner's specific circumstances.

The taxpayer also contends that finding the income at issue to be business income is contrary to decisions made by courts in other jurisdictions. In these cases, courts have found that income generated from the liquidation of assets is not business income under the functional test.[49] The Division, however, indicates that the Commission and courts in other jurisdictions have found that income generated from liquidations may satisfy the functional test. First, the Division referred the Commission to *USTC Appeal No. 11-2285* (Initial Hearing Order Oct. 2, 2013),[50] in which the Commission found that income generated from the sale of a single asset held by a holding company met the functional test and was business income. In that case, the petitioner, like the taxpayer in the instant case, had also argued that it had no business operations and, thus, could have no business income. The Commission rejected this argument, stating:

> This argument ignores the fact that taxpayer and the Underlying LP were both created to invest capital in BUSINESS-5 and then to realize a profit from it, activities that constituted their regular trade or business operations. As a result, the acquisition and disposition of an

49 *See, e.g., Uniroyal Tire Company v. Department of Finance*, 779 So.2d 227 (Ala. 2000); *Kemppel v. Zaino*, 746 N.E.2d 1073 (Ohio 2001); and *Lenox, Inc. v. Tolson*, 548 S.E.2d 513 (N.C. 2001). The taxpayer also cited cases where jurisdictions had found that such income is not business income under the transactional test. Because the Division does not rely on the transactional test in the instant matter, these cases are not particularly helpful.

50 The petitioner appealed the Commission's Initial Hearing decision, but the matter was settled prior to the Formal Hearing.

> asset, in this case the interest in BUSINESS-5 constitutes an integral part of the taxpayer's and the Underlying LP's regular trade or business operations and served an operational function. Accordingly, the income from the BUSINESS-5 sale qualifies as business income under the functional test.

Second, the Division referred the Commission to *USTC Appeal No. 09-3091* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 10, 2011), in which the Commission considered another case where the petitioner argued that its income could not be business income because it was a holding company that had no trade or business. In that case, the Commission rejected the petitioner's argument and concluded that the petitioner's "business was to own and manage its interests including its subsidiaries that held operating entities." The Commission also indicated that its interpretation and application of the functional test was similar to that of the California Supreme Court's, which in *Hoechst* had found, as follows:

> Forming these interpretations of the statutory language into a cohesive whole, we conclude that income is business income under the functional test if the taxpayer's acquisition, control and use of the property contribute materially to the taxpayer's production of business income. In making this contribution, the income-producing property becomes interwoven into and inseparable from the taxpayer's business operations. Such an interpretation of the functional test flows from the ordinary meaning of the statutory language and the California decisions that formed the basis for the UDITPA definition of "business income."

Third, the Division cited cases from jurisdictions where courts have found that the income generated from the liquidation of assets can meet the functional test and be classified as business income.[51] In *Harris*, the Arizona Court of Appeals held that income from the liquidation of assets could satisfy the functional test and be classified as business income because to do otherwise:

> . . . would result in a lack of symmetry. Assets would be depreciated and expenses deducted, reducing business income prior to disposition of the assets, but upon sale any gain would become nonbusiness income under a liquidation exception. Consequently, a single state might capture all the income while the states that had previously allowed expenses on an apportioned basis would shoulder the deductions.

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51 *See Harris Corp. v. Arizona Dept. of Rev.*, 233 Ariz. 377 (Ariz. Ct. App. 2013); *First Data Corp. v. Arizona Dept. of Rev.*, 313 P.3d 548 (Ariz. Ct. App. 2013); *Crystal Communications, Inc. v. Dept. of Rev.*, No. 4769, 2010 WL 2827462 (Or. Tax Ct. Jul. 19, 2010) *aff'd on other grounds*, 297 P.2d 1256 (Or. 2013); *Jim Bean Brands Co. v. California Franchise Tax Bd.*, 34 Cal. Rptr. 3d 874 (Cal. App. 1d 2005).

The Court's reasoning in *Harris* is persuasive. In the instant case, a portion of the ordinary business income and losses generated by the BUSINESS-1 interest had been apportioned to TAXPAYER for many years prior to the 2009 sale. The ordinary business income and losses apportioned to TAXPAYER would have incorporated a similar portion of BUSINESS-1's expenses and deductions. To treat the sale of the BUSINESS-1 asset as nonbusiness income could possibly allow another jurisdiction to capture the income from the sale even though Utah had previously shouldered the expenses and deductions associated with the asset.

Admittedly, courts in some of the older cases that the taxpayer cited have found that the income arising from the sale of an asset does not meet the functional test and, thus, is not business income. However, the Commission has historically found otherwise and finds that its position is reasonably supported by courts in a number of other states. All of the cases that the parties have cited are distinguishable from the circumstances present in this case. Nevertheless, the cases cited by the Division are similar enough to provide support for the Commission's determination that the income arising from BUSINESS-2's sale of its BUSINESS-1 interest is business income when it flows through to TAXPAYER.

In *Appeal No. 09-3091*, the Commission acknowledged that the Utah Fourth District Court had ruled differently. In *Chambers v. Utah State Tax Comm'n*, Case No. 050402915 TX, *judgment vacated on grounds of mootness*, No. 20070467, Utah Sup. Ct., Jan. 25, 2008, Judge Schofield found that the Commission's and the *Hoechst* court's interpretations of the functional test were too broad. The Commission appealed Judge Schofield's decision to the Utah Supreme Court. Before the Utah Supreme Court could issue a ruling and perhaps provide a final resolution of the issue, however, the matter was closed, and Judge Schofield's decision was vacated. As a result, Judge Schofield's decision does not establish precedent for the Commission to follow. It is also noted that subsequent to Judge Schofield's decision, all of the court cases that the parties

cited appear to support the Commission's and the *Hoechst* court's interpretation of the functional test. As a result, it is not clear whether the Utah Fourth District Court or any other Utah court would reach the same conclusion today that Judge Schofield reached nearly a decade ago. Accordingly, until a Utah court provides otherwise, the Commission sees no need to abandon its historical interpretation of the functional test, which appears to be supported by most, if not all, of the court cases in which the issue has been addressed in recent years. For these reasons, the Commission finds that the income arising from the sale of the BUSINESS-1 interest is business income.

Apportionment of Business Income Arising from the Sale of the BUSINESS-1 Interest. Because the Commission has found that the income arising from BUSINESS-2's sale of its BUSINESS-1 interest is business income, the Division contends that this income should be apportioned to Utah using the same 100% factor with which the ordinary business income generated by BUSINESS-1 was apportioned to Utah. The Division contends that such a result is supported by Subsection 59-7-303(2), which provides that "[a]ny taxpayer having income solely from business activity taxable within this state shall allocate or apportion its entire adjusted income to this state." The Division also contends that such a result is appropriate because both BUSINESS-2 and BUSINESS-1 were Utah companies on February 25, 2009, when the sale occurred, because neither company was engaged in business outside of Utah on this date, and because the income at issue was derived from the sale of an interest in a Utah operating company (i.e., BUSINESS-1).

In addition, the Division contends that the apportionment factors of BUSINESS-1 flow up to BUSINESS-2 and TAXPAYER for any income associated with BUSINESS-1, including the sale of an interest in BUSINESS-1, pursuant to Rule 8(11), which provides, as follows:

> . . . Income or loss from partnership or joint venture interests shall be included in income and apportioned to Utah through application of the three-factor formula consisting of property, payroll and sales. For apportionment purposes, the portion of partnership or joint venture property, payroll and sales to be included in the corporation's property, payroll and sales factors shall be computed on the basis of the corporation's ownership interest in the

> partnership or joint venture, and otherwise in accordance with other applicable provisions of this rule.

The taxpayer contends that Subsection 59-7-303(2) and Rule 8(11)(e) are not useful in apportioning the interest and capital gains income at issue because this income arose at the BUSINESS-2 level and because the ordinary business income that TAXPAYER apportioned to Utah at 100% arose at the BUSINESS-1 level. As a result, the taxpayer contends that the 100% apportionment factor based on BUSINESS-1's property, payroll, and sales factors should not be used to apportion the income that was generated when BUSINESS-2 sold its interest in BUSINESS-1. The taxpayer contends that the interest and capital gains income that arose at the BUSINESS-2 level must be apportioned to STATE-1 because this is where BUSINESS-2's and/or TAXPAYER's "alleged" activities of acquiring, holding, and disposing of the BUSINESS-1 interest occurred and because BUSINESS-2's and TAXPAYER's officers and shareholders were all STATE-1 residents. The taxpayer argues that because all of BUSINESS-2's and/or TAXPAYER's alleged business activities would have had to have occurred in STATE-1, the three apportionment factors for BUSINESS-2, as set forth in Section 59-7-311 and Rule 8(4), would produce a 0% Utah apportionment factor for the interest and capital gains income at issue.

The Commission finds that the NAME-1 & 2 became STATE-1 residents prior to the February 25, 2009 date on which BUSINESS-2 sold the BUSINESS-1 interest, but too little information exists to determine whether they were also Utah resident individuals on this date or for any of the years at issue. The taxpayer points out that Subsection 59-10-305(2) provides that for purposes of apportioning business income, a taxpayer is considered to be taxable in another state if "that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." The taxpayer, however, has not shown that STATE-1 could have taxed the income at issue where the BUSINESS-1 interest was sold by a Utah entity and where no STATE-1 entity existed on February 25, 2009, the date when the income was realized and became

taxable.[52] Whether *the NAME-1 & 2* were STATE-1 residents and/or Utah resident individuals is not particularly useful in determining the state to which the business income of *TAXPAYER* should be apportioned because we are dealing with an entity level tax. Furthermore, the taxpayer has not shown whether it was the NAME-1 & 2 who oversaw the BUSINESS-1 interest for its use or benefit in BUSINESS-2's and/or TAXPAYER's trade or business and, if they did, whether they performed these duties at their STATE-1 home or at their Utah home.

The only state in which BUSINESS-2 and TAXPAYER were registered when BUSINESS-2 sold the BUSINESS-1 interest on February 25, 2009, is Utah. Neither BUSINESS-2 STATE-1 nor TAXPAYER STATE-1 had been created or was registered to do business in STATE-1 on this date. The business income at issue was generated by a Utah entity, BUSINESS-2, selling an interest in a Utah operating company, BUSINESS-1. In addition, this income was realized by another Utah entity, TAXPAYER. Furthermore, Utah Department of Commerce records shows that as late as December 2008, all of BUSINESS-2's and TAXPAYER's officers and directors had Utah addresses. The Utah addresses of BUSINESS-2's and TAXPAYER's officers and directors were not changed to STATE-1 addresses on December 17, 2008, which is after the April 2008 date that the NAME-1 & 2 claim to have become STATE-1 residents and which is the date when the Utah entities' registered agents were changed to BUSINESS-4 showing a Utah address. As a result, the only state in which BUSINESS-2's and/or TAXPAYER's activities of acquiring, holding, and disposing of the BUSINESS-1 interest appear to have occurred on or prior to the February 25, 2009 sales date is Utah.

52 REPRESENTATIVE-5 FOR TAXPAYER and the Division agree that all of the income arising from the February 25, 2009 sale was subject to taxation on this date, regardless of whether it was paid on an installment basis and taxed in subsequent years. As a result, the taxpayer's arguments as to what occurred in STATE-1 after February 25, 2009 have little, if any, effect on which state is able to tax the interest and capital gains at issue.

For these reasons, even if the taxpayer were correct that the payroll, property, and sales factors of BUSINESS-2, not BUSINESS-1, should be used to apportion the interest and gains resulting from BUSINESS-2's sale of its BUSINESS-1 interest, the taxpayer's information is insufficient to show that BUSINESS-2's factors, as of the February 25, 2009 sales date, would produce an apportionment factor for Utah that is different from the 100% Utah apportionment factor that BUSINESS-2 and/or TAXPAYER used to apportion the ordinary business income generated by BUSINESS-1. The taxpayer's evidence does not support its argument that the interest and capital gains income at issue should be apportioned to STATE-1. These findings support the Division's impositions of additional tax for all years at issue. Accordingly, the Commission should sustain the Division's assessments for all four years in their entireties.[53]

Allocation of Interest and Capital Gains Income Had it Been Found to be Nonbusiness Income. The Commission has found that the interest and capital gains arising from BUSINESS-2's 2009 sale of its BUSINESS-1 interest is business income. As a result, it is not necessary for the Commission to decide how this income, had it been found to be nonbusiness income, should be allocated. Nevertheless, it may be useful to do so. Section 59-7-306 provides that nonbusiness income shall be allocated as provided in Sections 59-7-307 through 59-7-310. Subsection 59-7-308(3) provides that to the extent that they constitute nonbusiness income, capital gains and losses from sales on intangible personal property are allocable to Utah if the taxpayer's commercial domicile is in Utah. Section 59-7-309 provides that to the extent it is nonbusiness income, interest is allocable to Utah if the taxpayer's commercial domicile is in Utah. As a result, had the capital gains and interest income at issue in this appeal been found to be nonbusiness income, it would have been allocable to BUSINESS-2's and/or TAXPAYER's commercial domicile.

"Commercial domicile" is defined in Subsection 59-7-302(5) to mean "the principal place from which the trade or business of the taxpayer is directed or managed." The taxpayer has not met its burden of proof to

53 The taxpayer did not separately challenge the Division's impositions of penalties and interest in the

show that the principal place from which BUSINESS-2's and/or TAXPAYER's trade or business was directed or managed, as of the February 25, 2009 sales date, is STATE-1 and not Utah. On this date, BUSINESS-2 and TAXPAYER were registered to do business in Utah, not STATE-1. The STATE-1 entities did not even exist on the February 25, 2009 sales date. The Utah entities continued to be registered in Utah for several years after the sale, even after the STATE-1 entities of the same names had been created and registered in STATE-1. Furthermore, the addresses of BUSINESS-2's and TAXPAYER's officers and directors continued to be the address of the NAME-1 & 2' Utah home, even though the registered agents of these entities were changed in December 2008 after the NAME-1 & 2 had become STATE-1 residents.

In addition, REPRESENTATIVE-3 FOR TAXPAYER indicated that he had little involvement in the direction or management of BUSINESS-2 and TAXPAYER. Even if the NAME-1 & 2 did have involvement in the direction or management of BUSINESS-2 and TAXPAYER, it is not clear that this management occurred at their STATE-1 home and not their Utah home, especially when it is considered that all of BUSINESS-2's and TAXPAYER's professional contacts appear to be with Utah individuals or entities. For these reasons, the Commission finds that the "commercial domicile" of BUSINESS-2 and TAXPAYER, as of the February 25, 2009 sales date, was in Utah. Accordingly, even were the interest and capital gains income at issue considered to be nonbusiness income, it would all be allocable to Utah, and the Division's assessments for all four years would be sustained.

CONCLUSIONS OF LAW

1. Subsection 59-1-1417(1) provides that the petitioner has the burden of proof in cases before the Tax Commission, subject to limited exceptions not applicable in this appeal. Accordingly, taxpayer is the petitioner in this case and, thus, has the burden of proof.

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event that the Commission sustained the Division's impositions of tax.

2. The acquisition, management, and disposition of the BUSINESS-1 interest that was sold on February 25, 2009 constituted integral parts of BUSINESS-2's and/or TAXPAYER's regular trade or business operations. As a result, the interest and capital gains income that arose from BUSINESS-2's sale of the BUSINESS-1 interest meets the functional test, as set forth in Rule 8(2)(c), and constitutes "business income," as defined in Subsection 59-7-302(4).

3. The taxpayer has not met its burden of proof to show that the business income that arose from the February 25, 2009 sale of the BUSINESS-1 interest should not be apportioned 100% to Utah in accordance with Section 59-7-311 and Rule 8(4).

4. If the income that arose from the February 25, 2009 sale were considered to be nonbusiness income, it would be allocated to BUSINESS-2's and/or TAXPAYER's "commercial domicile." Because the taxpayer has not shown that the commercial domicile of either of these entities was a state other than Utah on the February 25, 2009 sales date, any nonbusiness income arising from the sale would be allocated entirely to Utah.

5. Based on the foregoing, the Commission should sustain the Division's assessments for the four years at issue in their entireties.

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Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's assessments for the four years at issue in their entireties. It is so ordered.

DATED this _____ day of _____, 2016.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601et seq. and 63G-4-401 et seq.