14-608 & 14-735
TAX TYPE: CORPORATE FRANCHISE TAX
TAX YEAR(S): 2004-2011
DATE SIGNED: 06/15/2018
COMMISSIONERS: J. VALENTINE, R. PERO, R. ROCKWELL
EXCUSED: M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal Nos. 14-608 & 14-735 Account No. ##### Tax Type: Corporate Franchise Tax Tax Periods: 7/1/2004 to 6/30/2008 and 7/1/2008 to 6/30/2011 Judge: Phan

Presiding:
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: REPRESENTATIVE FOR TAXPAYER-1, Representative from FIRM
REPRESENTATIVE FOR TAXPAYER-2, TAXPAYER
For Respondent: REPRESENTATIVE FOR RESPONDENT-1, Assistant Attorney General
REPRESENTATIVE FOR RESPONDENT-2, Assistant Attorney General
REPRESENTATIVE FOR RESPONDENT-3, Manager, Corporate Franchise Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on November 14, 2017 for an Initial Hearing in accordance with Utah Code §59-1-502.5. The matter before the Commission is Petitioner's appeal of two Notices of Deficiency issued on February 7, 2014, finding a deficiency of corporate franchise tax against Petitioner. Petitioner timely filed appeals of the Notices of Deficiency and two appeals were opened. Appeal No. 14-608 involves the audit period of July 1, 2004 through June 30, 2008, which concluded tax and interest due in the amount of $$$$$.

Appeal No. 14-735 involves the audit period of July 1, 2008 to June 30, 2011, which concluded tax and interest due in the amount of $$$$$. No penalties were assessed with each audit.

APPLICABLE LAW

For purposes of corporate franchise tax, the definition of "unitary group" is found at Utah Code Subsection 59-7-101(30) (2011)[1] as follows:

> (a) "Unitary group" means a group of corporations that:
> (i) are related through common ownership; and
> (ii) by a preponderance of the evidence as determined by a court of competent jurisdiction or the commission, are economically interdependent with one another as demonstrated by the following factors: (A) centralized management; (B) functional integration; and (C) economies of scale.

"Common ownership" is defined at Utah Code Subsection 59-7-101(7) (2011) as follows:

> (a) "Common ownership" means the direct or indirect control or ownership of more than 50% of the outstanding voting stock of:
> (i) a parent-subsidiary controlled group as defined in Section 1563, Internal Revenue Code, except that 50% shall be substituted for 80%;
> (ii) a brother-sister controlled group as defined in Section 1563, Internal Revenue Code; or
> (iii) three or more corporations each of which is a member of a group of corporations described in Subsection (2)(a)(i) or (ii), and one of which is: (A) a common parent corporation included in a group of corporations described in Subsection (2)(a)(i); and (B) included in a group of corporations described in Subsection (2)(a)(ii).

Utah Code Subsection 59-7-302(1) defines what constitutes "business income" and "nonbusiness income" as follows:

> . . .
>
> (d) "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.
> . . .
>
> (h) "Nonbusiness income" means all income other than business income.

[1] For ease of reference, this decision cites to the Utah Code in effect for tax year 2011. The parties did not argue at the hearing that there had been any substantive changes in the Utah Code during the audit periods, however, there was a rule change noted subsequently.

Utah law provides for the 50% subtraction of dividends from unitary foreign subsidiaries on waters' edge combined returns as follows at Utah Code Sec. 59-7-106:

> (1) In computing adjusted income, the following amounts shall be subtracted from unadjusted income:
> . . .
> (k) subject to Subsection (3), 50% of a dividend considered to be received or received from a subsidiary that:
> (i) is a member of the unitary group;
> (ii) is organized or incorporated outside of the United states; and
> (iii) is not included in a combined report under Section 59-7-402 or 59-7-403;
>
> . . .
>
> (3) (a) For purposes of calculating the subtraction provided for in Subsection (1)(k), a taxpayer shall first subtract from a dividend considered to be received or received an expense directly attributable to that dividend.
> (b) for purposes of Subsection (3)(a), the amount of an interest expense that is considered to be directly attributable to a dividend is calculated by multiplying the interest expense by a fraction:
> (i) the numerator of which is the taxpayer's average investment in the dividend paying subsidiaries; and
> (ii) the denominator of which is the taxpayer's average total investment in assets.

Utah law provides for factor representation for the unitary foreign dividend paying companies in the apportionment factor of the waters' edge group at Utah Code Subsection 59-7-106(3)(c) as follows:

> (i) For purposes of calculating the subtraction allowed by Subsection (1)(k), in determining income apportionable to this state, a portion of the factors of a foreign subsidiary that has dividends that are partially subtracted under Subsection (1)(k) shall be included in the combined report factors as provided in this Subsection (3)(c).
> (ii) For purposes of Subsection (3)(c)(i), the portion of the factors of a foreign subsidiary that has dividends that are partially subtracted under Subsection (1)(k) that shall be included in the combined report factors is calculated by multiplying each factor of the foreign subsidiary by a fraction:
> (A) not to exceed 100%; and
> (B) (I) the numerator of which is the amount of the dividend paid by the foreign subsidiary that is included in adjusted income; and
> (II) the denominator of which is the current year earnings and profits of the foreign subsidiary as determined under the Internal Revenue Code.

Utah Admin. Rule R865-6F-8 (2008), in effect for the first audit period, provides additional guidance regarding what constitutes business versus nonbusiness income in relevant part:

> A. Business and Nonbusiness Income Defined. Section 59-7-302 defines business income as income arising from transactions and activity in the regular course of the taxpayer's trade or business operations. In essence, all income that arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of the Uniform Division of Income for Tax Purposes Act, (UDITPA), the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.
> 1. Nonbusiness income means all income other than business income and shall be narrowly construed.

Utah Admin. Rule R865-6F-8(2) (2009), in effect for the second audit period, provides additional guidance regarding what constitutes business versus nonbusiness income and what constitutes a unitary business as follows in relevant part:

> (2)Business and Nonbusiness Income.
> (a)Apportionment and Allocation. Section 59-7-303 requires that every item of income 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.
> . . .
> (d) Relationship of Transaction Test and Functional Tests to the United States Constitution.
> (i) The due process clause and the commerce clause of the United States Constitution restrict states from apportioning income as business income that has no rational relationship with the taxing state. The protection against extra-territorial state taxation afforded by these clauses is often described as the unitary business principle. The unitary business principle requires apportionable income to be derived from the same unitary business that is being conducted as least in part in the state.
> (ii) The unitary business conducted in this state includes both a unitary business that the taxpayer alone may be conducting and a unitary business that taxpayer may conduct with any other person. Satisfaction of either the transactional test or the functional test complies with the unitary business principle, because each test requires that the transaction or activity, in the case of the transactional test, or the property, in the case of the functional test, to be tied to the same trade or business that is conducted within the state. Determination of the scope of the unitary

business conducted in the state is without regard to the extent to which this state requires or permits combined reporting.

. . .

(e) Business and Nonbusiness Income Application of Definitions.

. . .

(iv) Dividends. Dividends are business income where the stock with respect to which the dividends were received arose out of or was acquired in the regular course of the taxpayer's trade or business operations or where the acquiring and holding of the stock 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.

(3) Unitary Business.

(a) Unitary Business Principle.

(i) The concept of a Unitary Business. A unitary business is a single economic enterprise that is made up of ether separate parts of a single business entity or a group of business entities related through common ownership that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. This flow of being part of a unitary business conducted both within and without the state is what provides the constitutional due process definite link and minimum connection necessary for the state to apportion business income of the unitary business even if that income arises in part form activities conducted outside the state. The business income of the unitary business is then apportioned to this state using an apportionment percentage provided by Section 59-7-311. This sharing or exchange of value may also be described as requiring that the operation of one part of the business be dependent upon, or contribute to, the operation of another part of the business. Phrased in the disjunctive, the foregoing means that if the activities of one business either contribute to the activities of another business or are dependent upon the activities of another business, those businesses are part of a unitary business.

. . .

(b) Determination of a Unitary Business.

(i) A unitary business is characterized by significant flows of value evidenced by factors such as those described in Mobil Oil Corp. v. Vermont, 445 US 425 (1980): functional integration, centralization of management, and economies of scale. These factors provide evidence of whether the business activities operate as an integrated whole or exhibit substantial mutual interdependence. Facts suggesting the presence of the factors mentioned above should be analyzed in combination for their cumulative effect and not in isolation. A particular characteristic of a business operation may be suggestive of one or more of the factors mentioned above.

. . .

(c) Indicators of a Unitary Business.

(i) Business activities that are in the same general line of business generally constitute a single unitary business, as for example, a multistate grocery chain.

> (ii) Business activities that are part of different steps in a vertically structured business almost always constitute a single unitary business. For example, a business engaged in the exploration, development, extraction, and processing of a natural resource and the subsequent sale of a product based upon the extracted natural resource, is engaged in a single unitary business, regardless of the fact that the various business steps in the process are operated substantially independently of each other with only general supervision from the business' executive offices.
>
> (iii) Business activities that might otherwise be considered as part of more than one unitary business may constitute one unitary business when the factors outlined in Subsection (3)(b) are present. For example, some businesses conducting diverse lines of business may properly be considered as engaged in only one unitary business when the central executive officers are actively involved in the operations of the various business activities and there are centralized offices that perform for the business the normal matters a truly independent business would perform for itself, such as personnel, purchasing, advertising, or financing.

DISCUSSION

The parties provided general information about Petitioner. Petitioner, CORPORATION-1, is based in STATE-1 and is a global manufacturer and marketer of food and other consumer products throughout the world. Petitioner had numerous domestic and foreign subsidiaries actively conducting business during the audit period. Petitioner filed Utah combined corporate franchise tax returns on water's edge basis for each year of both audits. The combined audit periods are from July 1, 2004 through June 30, 2011. In 1978, Petitioner had made its initial investment in CORPORATION-2 ("CORPORATION-2"), which is a foreign subsidiary. At that time, CORPORATION-2 was a manufacturer and marketer of branded products throughout COUNTRY-1.[2] These products were primarily coffee, tea, wine and tobacco. CORPORATION-2's headquarters and largest component of sales were in COUNTRY-2 and the products were not marketed in the United States. With the initial acquisition, CORPORATION-2 remained a separate corporation and retained its independent status with Petitioner only able to control 41% of CORPORATION-2's voting stock.[3] This did not change until 2002. From 2002 through 2012, CORPORATION-2 was a wholly owned subsidiary of Petitioner and Petitioner could control voting stock.

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[2] In this matter, Petitioner referred to CORPORATION-2 as if it were a single entity. The Division points out that according to Petitioner's 2005 Form 10-K, Petitioner's principal foreign subsidiary was CORPORATION-1/CORPORATION-2, which was a COUNTRY-2 Limited Liability Company headquartered in COUNTRY-2. The Division points out, however, that same Form 10-K listed that there were 19 additional international subsidiaries containing the initials "CORPORATION-2" and 28 international subsidiaries containing the name CORPORATION-2.

[3] Petitioner's Prehearing Brief, pgs. 3-4.

In 1987, Petitioner had acquired a household product and over the counter pharmaceutical company based in COUNTRY-3, the CORPORATION-3. Petitioner centralized management of its DIVISION under CORPORATION-2 soon after this acquisition, but later in the 1990s and early 2000s divested many of these business lines as well as the wine and tobacco lines. In 2005, Petitioner announced its Transformation Plan through which all international business would be recognized as a distinct business line and managed by CORPORATION-2. This plan was completed in 2005 and the purpose was to reorganize the business around distinct geographical markets. The US components of coffee and household products divisions were separated from CORPORATION-2 and managed from the US. However, from 2005 to 2012 Petitioner exited the US coffee business through a series of dispositions.

In June 2012, Petitioner spun-off its investment in CORPORATION-2 to its shareholders. CORPORATION-2 immediately was listed as a public company. In 2013, the CORPORATION-4 acquired all shares of CORPORATION-2. Petitioner, at this time, changed its name to COMPANY-1. In August 2014, COMPANY-2 acquired all shares of Petitioner.

In calculating Utah taxable income on its original Utah returns for tax years ending June 30, 2005 through June 30, 2007, Petitioner had filed a unitary return with the CORPORATION-2 subsidiaries and had excluded 50% of its foreign dividend income as "dividends from unitary foreign subsidiaries." Petitioner also subtracted an additional 30% of the dividend income as nonbusiness income to reflect an estimated amount of the tax benefit which would have resulted from factor representation for the foreign dividend paying companies. In its original Utah returns for tax years ending June 30, 2008 through June 30, 2011, Petitioner excluded a majority of its foreign dividend income as intercompany dividend elimination and 50% of additional foreign dividend income as dividends from foreign subsidiaries.

The Division audited Petitioner for the period of July 1, 2004 to June 30, 2008, issuing its first Notice of Deficiency on February 15, 2012. Petitioner did not appeal the audit and paid the balance due. Then on February 26, 2013, Petitioner filed amended returns for tax years July 1, 2004 through June 30, 2008 claiming a refund. These amended returns excluded 50% of the foreign dividend income and subtracted an additional 30% as nonbusiness income to reflect an estimated amount of tax benefit, which would have resulted from factor representative for the foreign dividend paying companies. There were also some other federal audit adjustments that Petitioner reported for these years. On February 7, 2014, the Division issued a Notice of Deficiency denying the refund for the July 1, 2004 through June 30, 2008 period and a deficiency was asserted due to the federal audit adjustments

On that same date, February 7, 2014, the Division also issued a Notice of Deficiency for tax years July 1, 2008 through June 30, 2011, the second audit period. This audit allowed the 50% subtraction for foreign dividends, net of related expenses, and included factor representation for the foreign dividend paying companies in the apportionment factors. Petitioner timely appealed both February 7, 2014 Notices of Deficiency, and these are the audits at issue in this matter.

In the audits at issue, the Division found that Petitioner conducted an integrated business with its numerous majority-owned domestic and foreign subsidiaries and the Division included foreign dividends from Petitioner's wholly owned subsidiaries in Petitioner's combined report. The Division allowed Petitioner to take a 50% dividends-received deduction for the dividends received from Petitioner's foreign subsidiaries and included factor representation for the foreign dividend paying companies in the apportionment factors of Petitioner.

Petitioner contests the audit arguing that CORPORATION-2 was a non-unitary subsidiary during the audit period and also argues the dividends paid by CORPORATION-2 were nonbusiness income to Petitioner. Therefore, Petitioner argues, the dividend income should not have been included in Petitioner's apportionable income calculation.

For its argument that CORPORATION-2 was not a unitary group with Petitioner, Petitioner points to the definition of "unitary group" at Utah Code Subsection 59-7-101(30), which provides that a "unitary group" is a group of corporations that are "related through common ownership" and "are economically interdependent" as demonstrated by: 1) centralized management; 2) functional integration; and 3) economies of scale. CORPORATION-2 was the wholly owned subsidiary of Petitioner and, therefore, the "common ownership" was not in dispute. However, Petitioner argued they were not economically interdependent because there was no centralized management, functional integration or economies of scale.

Petitioner did proffer the argument at the hearing that the CORPORATION-2 group functioned separately from Petitioner's U.S. subsidiaries and many of the CORPORATION-2 subsidiaries were not unitary with Petitioner. It was Petitioner's proffer that CORPORATION-2 had always been a separate self-contained unit ready to operate on its own from the time Petitioner acquired CORPORATION-2 until it had spun it off. During this period, CORPORATION-2 always had its own legal and tax departments and its own management. CORPORATION-2 also had acquired and sold subsidiaries of its own. Petitioner proffered at the hearing that CORPORATION-2 had its own management structure that managed all its own day-to-day operations. Petitioner proffered that CORPORATION-2 owned its own trademarks, as far as COUNTRY-1, but Petitioner did own the CORPORATION-2 trade name in the U.S. Petitioner

argued that there were no economies of scale regarding Petitioner's US coffee business and the CORPORATION-2 coffee business. Petitioner's US coffee business purchased and roasted its own coffee beans and had its own brand name. Petitioner also indicated that the U.S. line was more focused around foodservice coffee sales and liquid coffee. CORPORATION-2 not only sold coffee in COUNTRY-1 but also was a big line in COUNTRY-4, as well as COUNTRY-5. Petitioner also argued that the house and body care product lines were also separate. CORPORATION-2 managed the home and body care lines in COUNTRY-1 while Petitioner operated different house and body care lines in the U.S. Petitioner did provide that currently Petitioner had not been able to consolidate into one information technology system regarding order management, sales, manufacturing and supply chain, planning and finance so the businesses were not consolidated in that manner. Prior to the hearing, Petitioner had not provided a comprehensive listing of its foreign subsidiaries, and the ones it was conceding were unitary and those that it was arguing were not unitary. Numerous foreign corporations were at issue in this audit.

In this matter, Petitioner argued that separately from the Utah Law, the United States Constitution restricted states from apportioning income that has no rational relationship with the taxing state under the unitary business principle, citing *F.W. Woolworth v. New Mexico*, 458 US 354 (1982) and *ASARCO v. Idaho*, 458 US 307 (1982). It was Petitioner's contention under these cases that taxation of DE's dividends in Utah would be unconstitutional.

Petitioner argued that alternatively, even if CORPORATION-2 and the Petitioner were unitary, CORPORATION-2's dividends were nonbusiness income and, therefore, not apportionable as business income. Utah uses either the transactional test or the functional test to determine if an item of income is business income. Utah Admin. Rule R865-6F-8(2) defines the transactional test to be that, "Business income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business." The functional test provides, "Business income also includes income arising 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."

Petitioner argues that the dividend paid by CORPORATION-2 did not constitute business income under the transactional test and that it should be seen as an investment. Petitioner argues that because Petitioner held the CORPORATION-2 stock independently from the Petitioner's operations as an investment, the dividends also do not constitute business income under the functional test.

Separately from the business/nonbusiness argument, Petitioner argues that because Utah allows for 100% of dividends to be deducted if paid by a domestic subsidiary, but only allows 50% of dividends to be deducted if paid by a foreign subsidiary, that this causes discrimination against foreign commerce pursuant to the US. Supreme Court's decision in *Kraft General Foods, Inc. v. Dep't of Revenue*, 505 U.S. 71 (1992).

Petitioner also argued at the hearing that the reason Petitioner had originally filed unitary returns for the audit period was due to an audit and settlement for prior years. Petitioner had indicated it did not necessarily represent that Petitioner thought the CORPORATION-2 business was unitary with Petitioner, but had instead done so because that was the Division's position in the prior appeals. There had been two previous audits and appeals that were resolved by settlement between Petitioner and the Division. The first was Appeal No. 98-0628, which had involved an audit period for the years July 1, 1991 through June 30, 1995. There had also been Appeal No. 06-1193, which involved the audit period of July 1, 1997 through June 30, 1998 and July 1, 2000 through June 30, 2003.[4]

The Division argues that Petitioner and its majority owned subsidiaries were conducting a unitary business during the audit periods. The Division points to the fact that the original returns filed during the audit years were combined returns filed by a unitary group. Therefore, contemporaneously with the first audit period Petitioner was filing returns in the manner consistent with the Division's position. For tax years July 1, 2004 through June 30, 2007, the returns reflect a filing position that all dividend paying foreign subsidiaries were unitary with Petitioner. For tax years July 1, 2008 through June 30, 2011, the returns reflect the position that some of the dividend paying foreign subsidiaries were unitary with Petitioner.

The Division also argues the interdependence of Petitioner and the subsidiaries based on the fact that Petitioner held itself out as a "global" company. The Division argued that many of Petitioner's directors and executive officers have held positions in both domestic and foreign entities of Petitioner. The Division was able to point to five individuals who were officers of both Petitioner and its U.S. subsidiaries and also officers of the foreign subsidiaries. The Division points to the Petitioner's 2005 Transformation Plan as evidence of the strong existing unitary relationships between all of Sara Lee's domestic and foreign operations subsidiaries. The Division had obtained through discovery a number of Powerpoint presentations to shareholders or boards of directors during the years in question that did appear to indicate that the DE businesses and other home and personal care subsidiaries in COUNTRY-1 and COUNTRY-6 were part of

[4] Respondent's Exhibits 1 through 3.

the global business of Petitioner.[5] It was the Division's contention that after reviewing information provided by the Petitioner that, "The unitary nature of [Petitioner's] domestic and foreign operations facilitated the implementation of the transformation plan in a manner allowing responsibilities to be shifted among subsidiaries in order to benefit the operations of the entire unitary group."[6]

The Division also argued that financial interdependence had been demonstrated by the fact that foreign sourced earnings were utilized to partially fund U.S. cash requirements. The Division pointed to Petitioner's 2009 Annual Report 10-K, which had disclosed that, "Since 2006, the corporation has adopted a policy of repatriating a higher level of foreign sourced earnings to partially fund U.S. cash requirements. The COMPANY business that was spun off in 2007 historically generated a significant amount of cash from operations within the U.S., which was used to service debt payments, dividends and other domestic capital requirements. As a result of the spin-off of COMPANY and the disposition of a number of significant COUNTRY-1an operations, the corporation has repatriated a portion of earnings annually since 2006 and will likely continue to do so in the future."[7]

The Division points out that it had allowed both the 50% adjustment and the factor representation allowed in Utah Code Sec. 59-7-106(1) and 59-7-106(3)(c) and has taxed the dividend income based on Utah law. It was the Division's position that Utah's treatment of dividends from foreign subsidiaries did not violate the Commerce Clause of the United States Constitution as addressed by the U.S. Supreme Court in the *Kraft General Food, Inc. v. Dep't of Revenue*, 505 U.S. 71 (1992). Utah is water's edge combined reporting state. In states such as Utah where the combined income to be apportioned is confined to the U.S.'s water's edge the Division states that different tax treatment of dividends paid by unitary domestic and unitary foreign subsidiaries does not violate the Commerce Clause. The Division had argued, "Not only does this differential treatment not violate the commerce clause, but such differential treatment is necessary to avoid a double tax on income of a domestic subsidiary." This is because the income of the domestic subsidiary is taxed in Utah and the income of the foreign subsidiary is not. So when dividends from a domestic subsidiary are not taxed, but dividends received from a foreign subsidiary are taxed, taxing symmetry is achieved because the domestic subsidiary's income is subject to taxation in the state while the foreign subsidiary's income is not.[8]

[5] See Respondent's Exhibits 24 through 43. Some of these materials were also included in Petitioner's Exhibits.
[6] Respondent's Exhibit 25. Respondent's Prehearing Brief, pg. 8.
[7] Respondent's Exhibit 13, pg. 36; Respondent's Prehearing Brief, pg. 9.
[8] Respondent's Prehearing Brief, pg. 13.

*Kraf*t involved taxation in the state of STATE-2. STATE-2, unlike Utah, was a single-entity reporting state, which meant that neither the domestic nor the foreign subsidiaries' income was taxable in STATE-2. Dividends were taxable, but STATE-2 allowed for a deduction for dividends received from domestic subsidiaries but not for dividends received from foreign subsidiaries. The U.S. Supreme Court found this violated the Foreign Commerce Clause.[9] Utah law differed because in Utah under the Petitioner's water's edge combined filing the income of the domestic unitary subsidiaries was subject to apportionment and taxation in Utah, but the income from the foreign subsidiaries was not. By taxing the foreign entity dividends, Utah achieves taxation symmetry by taxing the income of domestic subsidiaries and dividends from foreign subsidiaries with the 50% deduction.

After reviewing the law and the parties' arguments in this hearing, Petitioner is arguing both that the CORPORATION-2 group of subsidiaries were not unitary and the dividend income from the CORPORATION-2 group of subsidiaries constituted nonbusiness income.[10] The Petitioner has the burden of proof in this matter and the information submitted at the hearing by the Auditing Division from Petitioner's Form 10-K filings and information from Petitioner's Board of Directors meetings, as well as the fact that contemporaneously with the audit period, when the original returns were filed, Petitioner had treated this CORPORATION-2 group of subsidiaries as unitary in its filings, the conclusion to treat these subsidiaries as unitary was appropriate. The Petitioner has not provided sufficient evidence to the contrary. There were clearly a large group of the foreign subsidiaries and if there were some in the CORPORATION-2 that are not unitary, Petitioner has not sufficiently provided support as to which subsidiaries should be separated out from the unitary group. Because these dividends were paid to Petitioner as part of the unitary group, they are apportionable income subject to tax in Utah, although allowing the 50% exclusion and factor representation is appropriate.

The Respondent had noted if these dividends constituted business income paid from non-unitary foreign subsidiaries, 100% of the dividends would be included in apportionable income and subject to tax in Utah and there would be no 50% exclusion or factor representation. Because they are dividends from unitary foreign subsidiaries, they receive the more favorable tax

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[9] Respondent's Prehearing Brief, pg. 14; citing *Kraft* at 505 U.S. 81, 82. The Respondent also points out that the STATE-3 Supreme Court had issued a decision *In re Morton Thiokol, Inc.,* 864 P.2d 1175 (Kan. 1997) holding that *Kraft* only applies to states using single-entity reporting and not water's edge-reporting states.

[10] The Respondent points out that if CORPORATION-2 subsidiaries were non-unitary and the dividends were considered business income, 100% of the foreign dividend income would be included in Petitioner's apportionable income and there would be no factor representation. The 50% deduction and factor representation under Utah Code Sec. 59-7-106 only applies to dividends received from subsidiaries that were part of the unitary group.

treatment. Furthermore, the Respondent pointed out that even if these subsidiaries were non-unitary, a position the Respondent disagreed with, the dividend income would be business income under the functional test,[11] therefore apportionable and taxable in Utah. The Commission agrees with the Division on the point that this income is business income.

After reviewing the information submitted at the Initial Hearing in this matter, Petitioner had not sufficiently supported its case, and the audits should be sustained.

Jane Phan
Administrative Law Judge

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[11] The Respondent points out if either the transactional test or functional test are met, income is business income. There does not need to be a showing under both tests. The Division cites to Utah Admin. Rule R865-6F-8(2)(d)(2009) as well as *Utah State Tax Commission Decisions Appeal No. 90-1607* (1992); *Appeal No. 97-1416* (1999); *Appeal No. 01-0005* (2002); and *Appeal No. 01-0172* (2003).

DECISION AND ORDER

Based on the foregoing, the Tax Commission sustains the Division's Corporate Franchise Audit Deficiencies issued for the audit periods of July 1, 2004 through June 30, 2008 and July 1, 2008 to June 30, 2011. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed, or emailed, to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

or emailed to:
taxappeals@utah.gov

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this ___________day of __________________, 2018.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Payment Requirement: Any balance due as a result of this order must be paid within thirty (30) days of the date of this order, or a late payment penalty could be applied.