STATE OF WISCONSIN

TAX APPEALS COMMISSION

AMERICAN HONDA MOTOR CO., INC., **DOCKET NO. 19-I-227**

Petitioner,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

RULING AND ORDER

LORNA HEMP BOLL, COMMISSIONER:

This case comes before the Commission for decision on cross-motions for summary judgment. The Petitioner, American Honda Motor Co., Inc., ("American Honda"), a California corporation, is represented by Attorneys Clark R. Calhoun and Kathleen S. Cornett of Alston & Bird, LLP, Atlanta, Georgia. The Respondent, the Wisconsin Department of Revenue ("the Department"), is represented by Attorney Mark S. Zimmer.

The determinative issue is whether the income from Petitioner's sale of CAFE credits and GHG credits should have been included as apportionable income on the combined Wisconsin corporate franchise tax return of Petitioner's unitary group for FYE 2015 when calculating Petitioner's Wisconsin tax liability. For the reasons stated

below, we find it should have been included and therefore rule in favor of the Department.

FACTS

Petitioner's Business

1. Petitioner, American Honda Motor Co., Inc. ("American Honda"), formed in 1959, is a California corporation with its headquarters and principal place of business in Torrance, California. American Honda is a wholly-owned subsidiary of Japanese parent corporation Honda Motor Co., Ltd. ("Japanese Parent Company"). (Stip., ¶¶ 1, 3, 4.)

2. American Honda is qualified to do business in Wisconsin and is in good standing with the Wisconsin Department of Financial Institutions. (Stip., ¶ 2.)

3. American Honda distributes Honda products in the United States. Products distributed by American Honda include Honda brand automobiles, trucks, motorcycles, ATVs, other equipment, and parts and accessories.[1] (Stip., ¶¶ 5, 6.)

4. American Honda buys Honda products exclusively from related companies that are part of American Honda's combined group, including but not limited to Honda of America Mfg. Inc., Honda of South Carolina Mfg., and Honda Transmission Mfg. of America, and resells them to dealers and other retailers. The foregoing companies are owned, directly or indirectly, by the Japanese Parent Company. (Stip., ¶ 7.)

[1] For the purpose of this action, references to "Honda brand" or "Honda products" also includes Acura, which is Honda's luxury brand.

5. These companies filed combined reports as a single unitary business. (Stip., ¶¶ 7, 9, 45.)

6. The total sales of Honda automobiles and parts in the State of Wisconsin by American Honda's combined group during the fiscal year ending March 31, 2015 ("FYE 2015" or the "Subject Year") was $646,729,219, and the total sales in the entire United States was $47,417,932,821. (Stip., ¶ 9.)

National Program Re: CAFE and GHG Credits

7. In the United States, fuel economy is regulated under the National Highway and Transportation Safety Administration's ("NHTSA's") Corporate Average Fuel Economy ("CAFE") standards. In addition, the Environmental Protection Agency ("EPA") regulates greenhouse gas ("GHG") emissions. Through a joint program (National Program"), the NHTSA and the EPA coordinate their compliance standards. This National Program requires that automakers' fleets become more fuel-efficient and have less of a GHG pollution impact over time. (Stip., ¶¶ 11, 13-15.)

8. Under the National Program, automakers that sell fleets that are more fuel efficient than applicable CAFE standards receive[2] credits ("CAFE Credits"), which are computed based on the average fuel economy of the car and truck fleets manufactured or sold by the automaker in the model year. CAFE Credits may be applied to any of the three model years immediately preceding the model year for which they are earned, and any of the five consecutive model years immediately after the model year for

[2] Although the Stipulation uses the term "receive," the Code utilizes the term "earn." *See* 49 U.S.C. § 32903(a) (2015) ("the manufacturer earns credits") and 40 C.F.R. §86.1865-12(k)(4) ("Credits are earned . . . .").

which they are earned. The CAFE Credits may be either sold or traded to other automakers that do not meet the applicable CAFE fuel economy standards or may be used to offset performance deficits in the future. (Stip., ¶¶ 18-19.)

9. If an automaker's fleet does not meet its CAFE targets and does not have Credits to use and does not purchase or obtain CAFE Credits from another automaker to offset the deficit, then the automaker must pay a significant civil penalty. See 49 U.S.C. § 32912. (Stip., ¶ 22.)

10. Under the National Program, automakers that sell fleets of certain types of vehicles that are less polluting than applicable EPA GHG standards also earn[3] credits ("GHG Credits."). GHG Credits generally expire five model years after the year for which they are received, but GHG Credits from the 2010 model year retain their full value through and including the 2021 model year. GHG Credits may be either sold or traded to other automakers that do not meet the applicable GHG standards or may be used to offset performance deficits in the future. (Stip., ¶¶ 23-24.)

11. Automakers selling fleets that do not meet applicable GHG pollution standards can purchase or obtain GHG Credits from other automakers in order to satisfy National Program GHG requirements. (Stip., ¶ 25.)

12. Each automaker's Credits[4] position is posted publicly. Using this public information, an automaker interested in acquiring Credits can contact automakers

[3] See previous FN.

[4] "Credits" and "Environmental Credits" are used interchangeably and refer to both GHG Credits and CAFE Credits.

that may be interested in selling Credits. (Affidavit of Jenny Gilger, Vice President of American Honda Motor Co. ("Gilger Aff."), ¶ 35.)

Petitioner's Participation in National Program

13. American Honda, as the United States distributor of Honda vehicles, is required to comply with the CAFE and GHG regulations, as they apply to the fleet of Honda vehicles manufactured by members of its combined group and distributed through American Honda[5]. (Stip., ¶ 27.)

14. During the period at issue, American Honda handled compliance with GHG, CAFE, and other regulations through its Product Regulatory Office in Torrance, CA. (Stip., ¶ 29; Gilger Aff., ¶ 33.)

15. Under the National Program, American Honda earned CAFE Credits and GHG Credits in every year prior to the FYE 2015 as a result of its mandatory regulatory filings for the CAFE and GHG programs, because the vehicle fleets sold by American Honda were more fuel-efficient and less polluting than applicable CAFE and GHG standards. (Stip., ¶ 28.)

16. From time to time, American Honda, in the person of the Assistant Vice President, Environment & Energy Strategy (the "AVP") for American Honda, sold Credits to other automakers. The parties to a sale of Credits by American Honda typically would enter into a Credit Purchase Agreement, which would include either a commitment or an option to purchase Credits. In some instances, a Credit Purchase

[5] For simplicity, although Petitioner is technically a distributor, by virtue of the combined group, we refer to American Honda as an "automaker" or "vehicle manufacturer."

Agreement gave the buyer opportunities or commitments to buy Credits over several years. (Stip., ¶¶ 31, 32, 34, 36.)

17. All Credit sales activity was conducted from California through Petitioner's Product Regulatory Office. (Petition, ¶ 28.)

18. The management and sales activity related to the Credits took up only about 4% of the AVP's time. (Gilger Aff., ¶ 44.)

19. The AVP was involved in numerous other activities for the combined group, including "being the face of Honda to the EPA, NHTSA, and other regulatory agencies." (Gilger Aff., ¶ 41.)

20. Credit sales transactions were conducted by the AVP with support from one other staff member. (Gilger Aff., ¶ 43.)

21. For larger agreements, American Honda's executive management approved the transactions. (Stip., ¶ 35.)

22. In all instances, American Honda Corporate Legal Counsel reviewed the Purchase Agreements. (Gilger Aff., ¶ 45.)

23. Under generally accepted accounting principles, the Credits were treated as intangible assets having a zero-cost basis; there was no cost basis to the Credits because they were granted by the government. (Stip., ¶ 42.)

24. Since the basis in the Credits was zero, American Honda recorded the entire amount realized from a Credit sale as gain, net any incidental transaction costs. (Stip., ¶ 43.)

25. The proceeds from Credit sales were reported as capital gains for federal income tax purposes. (Stip., ¶ 44.)

26. The proceeds from the Credit sales were not included as apportionable income on Petitioner's combined group's Wisconsin tax returns. (Stip., ¶ 45.)

Procedural Facts

27. A portion of the vehicles generating these CAFE Credits and GHG Credits were sold to dealers in Wisconsin, who in turn sold those vehicles within Wisconsin.[6] (Stip., ¶ 41.)

28. American Honda reported all income from the Credit sales as non-apportionable income on the combined Wisconsin corporate franchise tax return of its unitary group for FYE 2015. (Stip., ¶ 45.)

29. The Department conducted an audit of the Audit Period, comprised of fiscal years 2014 and 2015 (the "Assessment"). (Stip., ¶ 46, Ex. 1.)

30. On or about January 4, 2019, the Department received a Petition for Redetermination dated December 21, 2018, appealing the Notice of Amount Due. (Stip., ¶ 47.)

31. On June 27, 2019, American Honda and the Department's Resolution Officer entered into a Memorandum of Understanding settling all issues in the audit for 2014[7] and all issues in the audit for 2015 except for the characterization of the income from the Credit Sales as either apportionable or non-apportionable income.[8] Pursuant to

[6] Thus, the combined group is required to pay Wisconsin corporate franchise tax on income that is apportionable to Wisconsin.

[7] Although Stip. ¶ 33 seems to indicate otherwise, the Commission has confirmed that the parties stipulate that American Honda made no sales of Credits during the fiscal year ending March 31, 2014. Accordingly, American Honda's Wisconsin corporate franchise tax liability for FYE 2014 is not in dispute in this case.

[8] There is no dispute over the sales factor to be applied to the apportionable income.

the Memorandum of Understanding, the remaining amount of the Assessment in dispute is $298,675.30 of tax for the FYE2015 tax year and $151,710.69 of interest as of September 7, 2019, for a total of $450,385.98. (Stip., ¶ 48, Ex. 3.)

32. On July 9, 2019, the Department issued a Notice of Action denying American Honda's Petition for Redetermination in accordance with that Memorandum. (Stip., ¶ 50.)

33. On September 5, 2019, American Honda timely filed a Petition for Review with the Wisconsin Tax Appeals Commission, and the Wisconsin Department of Revenue filed a timely Answer on October 4, 2019. (Stip., ¶ 51.)

APPLICABLE LAW

> Wis. Stat. § 71.25(5) Corporations engaged in business both within and without the state.
> (a) *Apportionable income.* Except as provided in sub. (6) [not applicable here], corporations engaged in business both within and without this state are subject to apportionment. **Income gain or loss from the sources listed in this paragraph is presumed apportionable as unitary or operational income or other income that has a taxable presence in this state.** (emphasis added) Apportionable income includes all income or loss of corporations, other than nonapportionable income as specified in par. (b), including, but not limited to, income, gain or loss from the following sources:
> [24 examples of apportionable income]
> **3.** Sale of scrap and by-products.
> **9.** Interest and dividends . . . . In this subdivision, **"investment activity" includes decision making relating to the purchase and sale of stocks and other securities, investing surplus funds and the management and record keeping associated with corporate investments,** not including activities of a broker or other agent in maintaining an investment portfolio. (emphasis added)
> **10.** Sale of intangible assets if the operations of the company in which the investment was made were unitary with those of

> the investing company, or if those operations were not unitary but the **investment activity from which that gain or loss was derived is an integral part of a unitary business** and the companies were neither affiliates nor related as parent company and subsidiary. In this subdivision, **"investment activity" has the meaning given under subd.** 9.
>
> **(b)** *Nonapportionable income.* Income, gain or loss from the sale of nonbusiness real property or nonbusiness tangible personal property, rental of nonbusiness real property or nonbusiness tangible personal property and royalties from nonbusiness real property or nonbusiness tangible personal property are nonapportionable and shall be allocated to the situs of the property, except that all income that is realized from the sale of or purchase and subsequent sale or redemption of lottery prizes if the winning tickets were originally bought in this state shall be allocated to this state.

ANALYSIS

Petitioner is a distributor for a vehicle manufacturer[9] doing business in many states, including Wisconsin, as part of a combined group all owned by the same parent company. As such, the income of the group is generally subject to apportionment in Wisconsin under Wis. Stat. § 71.25(5).

Petitioner's combined group manufactures and sells vehicles which surpass the current requirements for certain environmental Credits. As a result, Petitioner earns Credits, which can be used to offset past or future manufacturing activity not in compliance with regulations, or the Credits can be traded or sold to other manufactures who can make use of them. During the tax period at issue, Petitioner had no need for the

[9] In keeping with FN 1, for simplicity, although Petitioner is technically a distributor, by virtue of the combined group, we refer to American Honda as an "automaker" or "vehicle manufacturer."

Credits it earned and so it took advantage of opportunities to sell its Credits to several other automakers.

The Credit sales activity did not occur in Wisconsin. Petitioner's business had an office in California it refers to as the Product Regulatory Office. That office was responsible for handling compliance with GHG, CAFE, and other regulations. An AVP in that office, whose role was described as "being the face of Honda to the EPA, NHTSA, and other regulatory agencies," was the person tasked with orchestrating the sales of the Credits earned through Petitioner's compliance with these regulations.

Because the Credit sales activities were run entirely from California, Petitioner did not include the income from the sale of the Credits in its Wisconsin apportionable income. The Department's audit concluded that the income from the sale of the Credits should be included in Wisconsin apportionable income. We agree with the Department.

Apportionment is an Appropriate Method for State Taxation of Unitary Businesses Doing Business Inside and Outside the State.

In order to pass constitutional muster, a state may only tax income that has a "minimal connection" or "nexus" between the interstate activities and the taxing state, and there must be "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Wisconsin Dep't. of Revenue v. Exxon Corp.*, 90 Wis. 2d 700, 281 N.W.2d 94 (1979), aff'd *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 221 (1980). In affirming the Wisconsin Supreme Court, the U.S. Supreme Court explained, "The 'linchpin of apportionability" for state income taxation of an interstate enterprise is

the 'unitary-business principle.' If a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *Exxon* at 447 U.S. at 223 (citations omitted).

Under this principle, Wisconsin may tax the income of companies doing business both in and out of this state. "Except as provided in sub. (6) [not applicable here], corporations engaged in business both within and without this state are subject to apportionment." Wis. Stat. § 71.25(5)(a). Wisconsin uses a statutory apportionment formula to determine its share of the income earned by multi-state corporations and groups of corporations. The formula Wisconsin currently uses is a single sales factor set forth in Wis. Stat. § 71.25(6)(d). The calculation of the sales factor is not in dispute. The sole issue is whether the income gained from the sale of the Credits is apportionable as Wisconsin income.

A portion of the Petitioner's vehicles generating these CAFE Credits and GHG Credits were sold to dealers in Wisconsin, who in turn sold those vehicles within Wisconsin. Thus, Wisconsin is entitled to tax a portion of the income of the combined group through apportionment as an approximation of the portion of group's corporate income reasonably related to activities in Wisconsin.

The question is whether the income from the sale of the Credits should be included in Petitioner's apportionable income.

Applicability of Specific Examples of Apportionable Income Listed in Wis. Stat. § 71.25(5)(a)

Wisconsin's apportionment statute begins by explaining that corporations are subject to apportionment unless their income comes from four specific sources listed in 71.25(5)(b), none of which apply to this case. The section includes 24 examples of apportionable income, explaining that the items listed are "presumed apportionable as unitary or operational income or other income that has a taxable presence in this state." The Credit sales activity does not fall neatly into any of the 24 examples.

The Department makes several valiant attempts to position the income from sale of the Credits as apportionable income specifically listed in Wis. Stat. 71.25(5)(a). The Department's first assertion is that the Credits fall into the category of "scrap or by-products." This argument requires an unreasonable stretch of linguistic interpretation. The terms "scrap" and "by-products" reasonably call to mind things produced or left over after manufacturing is complete. Scrap metal, sawdust, nutshells and oils, feathers – each of these is clearly a by-product or scrap resulting from a manufacturing process (metalwork production, wood-working, peanut butter production, poultry preparation). Income from the sale of these physical scraps/by-products is clearly apportionable under example (3).

The Commission's role in interpreting statutes is to apply reasonable meaning to the words used in the statutory language. *State ex rel. Kalal v. Circuit Court for Dane Cnty.*, 2004 WI 58, ¶ 45, 271 Wis. 2d 633, 663; 681 N.W.2d 110, 124 (2004). We decline

to expand the term "by-product" to include tax benefits earned by complying with federal regulations.

The Department also reaches to examples 9 and 10. The Credits are not stocks or bonds or securities, the sales do not involve surplus funds, and the Credits are not corporate investments. The Credits are not dividends or interest, and their sale is not investment activity as the statute defines it, so the examples of Wis. Stat. §§ 71.25(5)(a)(9) or (10) do not apply.

Standard for Inclusion in Apportionment

Under Wis. Stat. § 71.25(5)(a), whether income falls into one of the 24 examples is not determinative. The statute clearly notes that apportionable income includes *but is not limited to* those 24 examples. It further explains that those 24 examples are presumed apportionable because they are "unitary or operational income or other income that has a taxable presence in this state."

Thus, the income from the sale of the Credits is apportionable if it is (1) unitary income, (2) operational income, or (3) other income that has a taxable presence in this state. That is our standard.

Taxable Presence in the State

Taking these categories in reverse order, the parties have stipulated that the Credit sales are conducted from California and that none of the participants in the transactions have sufficient ties with Wisconsin. Thus, the income from these sales does not have its own taxable presence in Wisconsin.

The Credits Serve an Operational Function not an Investment Function

The U.S. Supreme Court has concluded that states may apportion income from a capital transaction if the asset "serve[s] an operational rather than an investment function." *Allied Signal, Inc. v. Dir.*, 504 U.S. 768, 787 (1992).

As the Court observed: "[Treating] particular intangible assets as serving, on the one hand, an investment function, or, on the other, an operational function . . . . is the relevant unitary business inquiry, one which focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing state." *Allied-Signal*, 504 U.S. at 785. In determining whether an asset serves an investment or operational function, the key question is whether an asset "is an integral part of an enterprise." This is the test for investment versus operational assets.

The standard dovetails with the Wisconsin statutes which use the term "integral" only in the context of investment activity. Wis. Stat. §§ 71.25(5)(a)(9) (dividends and interest) and (10) (intangible investments such as stocks and bonds).

In arguing whether the Credits are integral to the unitary enterprise, Petitioner relies heavily on a state court case from Oregon. *Willamette Indus., Inc. & Subs. v. Dep't of Revenue*, 15 P.3d 18 (Ore. 2000). Oregon follows UDITPA, which presents somewhat different standards, but we will note that the assets sold in *Willamette*, mineral rights from out-of-state timber land owned by a forest products operation, were completely independent from (not integral to) the forestry business, beyond their common ownership. The mining rights and the forest products operation could have

existed completely separately. The mineral rights were not integral to the forest products business. Thus, they were found not to be operational assets, so the income from the mineral rights was not apportionable.

Petitioner's situation is not analogous. The Credits were not unrelated to Petitioner's unitary business. American Honda earned the Credits through its manufacture and distribution of fuel-efficient and low-polluting vehicles. There is no guarantee American Honda may not need the Credits in the future, should federal pollution and fuel efficiency standards change. Should that situation arise, these Credits would clearly be integral as operational assets since they would save American Honda and its related entities the expense of meeting fuel efficiency and emissions standards. The Credits are inextricably tied to, that is, integral to the automaking operations.

Moreover, Petitioner did not purchase or invest in the Credits in anticipation of appreciation as an investment is commonly understood, nor were the Credits traded among investors seeking profits from appreciation. Automakers who earn Credits but have no current use for them may trade or sell them to other automakers who do use them to offset non-compliance with federal environmental regulations. The Credits are operational, and the income American Honda earns from selling excess Credits is operational income and is for that reason apportionable.

The Credit Sales Income is Unitary Income

The income from Credit sales also falls within the third category – it is unitary income. Under the standards described in *Exxon*, for income from the Credit sales to be excluded from the Wisconsin apportionment formula, Petitioner must prove that

the income from Credit sales was earned from activities unrelated to, in this case, the manufacture and distribution of vehicles. If the Credit sales income is derived from "unrelated business activity" which constitutes a "discrete business enterprise," then it is excluded. To make this determination, *Exxon* instructs us to examine the "underlying economic realities of a unitary business." *Exxon* at 223-224, citing *Mobil Oil Corp. v. Comm'r of Taxes of Vermont,* 445 U.S. 425, 438-442, 100 S. Ct. 1223, 1232 (1980).

The question in *Exxon* was whether the marketing department, the only portion of the company located in Wisconsin, was sufficiently segregated so as not to be unitary with the other primary functions of the oil production company located outside the state. The U.S. Supreme Court affirmed that the various divisions were clearly functionally integrated for the benefit of the business as a whole, and therefore they formed a unitary enterprise.

The taxpayer in *Mobil Oil* attempted to segregate out the function of receiving dividends from a subsidiary as non-apportionable. In rejecting that argument, the Supreme Court stressed the significance of the unitary-business principle: "In accord with this principle, what appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that State." The income in question was not from unrelated activities and was therefore apportionable.

Similarly, American Honda has not shown that the income from the sale of the Credits was earned in the course of activities unrelated to the business of American Honda's unitary group. Quite the contrary. As the marketing division in *Exxon* was

unitary with the oil producer, the Petitioner's compliance division is unitary with American Honda's combined group. Complying properly with the federal regulations produces benefits for the unitary group. Not only does American Honda produce acceptable fuel efficient low-polluting vehicles, but it also earns the Credits. The unitary group could potentially use the Credits, and in the alternative it may sell them to make the excess Credits productive.

The AVP who sells the Credits is the person the unitary group has called upon to be "the face of Honda to the EPA, NHTSA, and other regulatory agencies." The AVP's role includes dealing with the regulatory agencies to manage the Credits. Other automakers seek out this AVP as the contact person for American Honda. After negotiating sales, the AVP works with American Honda's Corporate Legal Counsel, who reviews all purchase agreements. American Honda's executive management is called in to approve larger deals. Once deals are made, the AVP then works with the regulatory agencies to transfer Credits held by the unitary business into the accounts of other automakers. There is no evidence to show that the AVP is paid separately for these activities. Another staff person, also employed by the unitary business, assists the AVP. They use company equipment, company office space, and company time to carry out this sales activity. To carve out this small portion of the AVP's compliance position (4% of his time) simply to segregate the Credit sales income from Petitioner's unitary group income seems to subvert the idea that American Honda's Product Regulatory Office compliance group is a part of the unitary enterprise.

Petitioner's compliance activities, performed through its Product Regulatory Office, are clearly functionally integrated with the vehicle manufacturing for the benefit of the whole, per *Exxon*. Given the significant use of the unitary group's resources, the sale of the Credits is not the sort of "unrelated business activity" which constitutes a "discrete business enterprise" envisioned by the Court in *Exxon*. Moreover, per *Mobil Oil*, the income is apportionable because it was earned in the course of compliance activities which are very much related to the automaking business.

Petitioner attempts to recharacterize the subject matter here by focusing on the Credits alone as an asset and then arguing using the "integral to the unitary business" standard. That standard, discussed above, is the standard for determining whether an asset is an investment as opposed to an operational asset. (See previous section.) This case does not involve the sale of an isolated unrelated asset, like the mineral rights in *Willamette*. The AVP did not happen upon the Credits and decide to sell them. Rather, the AVP's job involves overseeing American Honda's compliance with federal regulations which allows American Honda to earn the Credits. The compliance role requires the AVP to work with the regulators not only regarding all aspects of these Credits but regarding all aspects of regulatory compliance.

Although this case involves one of the earliest years, the sale of Credits is an on-going activity which requires the cooperation and coordination of company unitary resources. The unitary enterprise generates the Credits, allows for public posting of Credits it determines are not useful, negotiates purchase agreements, reviews the legalities of those agreements, provides executive approvals, and works with regulators

to authorize transfer the Credits away from the unitary business. Thus, the income from the Credit sales activity is unitary income.

Misc. Caselaw

Petitioner offers a U.S. Supreme Court case from Idaho to argue that a "but for" relationship between Petitioner and Credit sales is insufficient. *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982). We reject this argument. 1) The Idaho case relies on UDITPA, which has not been adopted in Wisconsin, and which may cloud the issues as to appropriate standards, and 2) The Idaho case involved sales of stock investments which were clearly unrelated to the business. We do not disagree with the Court's comments that it takes more than simply increasing a company's coffers to create a unitary relationship. Furthering the company purpose of making money would indeed be too broad of a standard. But the case at hand does not involve the sale of an investment, rather it involves the sale of assets earned by the unitary enterprise and sold using the unitary group's personnel and resources.

The Department offers a case from the Supreme Court of Arkansas involving this same taxpayer and these same facts. Because, like Idaho, Arkansas follows UDITPA, the standards do not match those of Wisconsin. However, the Arkansas court's characterization of American Honda's business model is thought-provoking. In considering the "unitary business principle," the court found Honda's proceeds from Credit sales were apportionable because, "while American Honda's regular course of business is distributing American Honda vehicles and products, it also maintains a

regular course of business of selling environmental credits." Due to the differing legal standards, we will not apply the Arkansas holding.

A Final Review of Wis. Stat. 71.25(5)(a)

The foregoing analysis dictates that the Credit sale income is apportionable. We close by confirming that this conclusion dovetails with the Wisconsin Statutes.

First, Wis. Stat. § 71.25(5)(b) provides that several types of "non-business" assets are non-apportionable. That makes sense given the requirement that apportionable assets be unitary and integral to the unitary business as operational assets. The statutes and caselaw clearly do not intend for income from sources unrelated to the unitary business to be apportioned. However, the Credits are neither real nor tangible personal property, so the subsection does not directly preclude apportionment.[10]

Although the Credit sales activity does not fall expressly into any of the 24 apportionable examples of 71.25(5)(a), the list illustrates the types of income that are apportionable by virtue of being "unitary or operational income or other income that has a taxable presence in this state." The Credit sales activity is strongly analogous to the third example.

As noted above, the Credits are not literally by-products, but the similarities are striking. Assume, for example, that vehicle production results in leftover upholstery or that the manufacturer purchased more upholstery than it could use. Assume the manufacturer has no need for the excess upholstery. Assume an AVP of the manufacturer

[10] Petitioner comments on the lack of clarity in subsection (b) as it may apply to some intangibles, such as out of state lottery winnings. This case does not involve lottery winnings so we do not comment beyond noting the possibility that not all income from intangibles may qualify as Wisconsin apportionable income.

is contacted by another automaker who could use the upholstery not needed by the manufacturer. The AVP makes time to negotiate with the other automaker and sells the upholstery. In this scenario, the income from the sale is clearly apportionable under Wis. Stat. § 71.25(5)(a)(3).

In American Honda's case, vehicle production results in Credits for the unitary business. Petitioner has no current need for the Credits. An AVP is contacted by other automakers who are aware of Petitioner's Credits. The AVP sells the Credits to other automakers who can make use of the Credits. We do not see a significant distinction. Just as the income from the by-product sale is presumed apportionable as unitary income, the Credit sales activity similarly creates income for the unitary business. By analogy to an apportionable example listed in Wis. Stat. § 71.25(5)(a), the Credit sales income is apportionable.

CONCLUSIONS OF LAW

1. The Credits are integral to the Petitioner's unitary business because they serve an operational, not investment, function. The resulting income is operational income, which is apportionable under Wis. Stat. § 71.25(5)(a).

2. Petitioner's income derived from selling the Credits is unitary income, which is apportionable under Wis. Stat. § 71.25(5)(a).

3. Petitioner's income derived from selling Credits is sufficiently analogous to income derived from the sale of by-products, which is expressly presumed unitary and apportionable under Wis. Stat. § 71.25(5)(a)(3), such that the income from the Credit sales is apportionable Wisconsin income under Wis. Stat. § 71.25(5)(a).

ORDER

For the reasons explained above and in accordance with these Conclusions of Law, it is ordered that the Department's Assessment is upheld, and the Petition for Review is dismissed.

Dated in Madison, Wisconsin, this 29th day of November, 2021.

WISCONSIN TAX APPEALS COMMISSION

Elizabeth Kessler, Chair

Lorna Hemp Boll, Commissioner

Jessica Roulette, Commissioner

ATTACHMENT: NOTICE OF APPEAL INFORMATION

WISCONSIN TAX APPEALS COMMISSION
5005 University Avenue - Suite 110
Madison, Wisconsin 53705

NOTICE OF APPEAL INFORMATION

NOTICE OF RIGHTS FOR REHEARING, OR JUDICIAL REVIEW, THE TIMES ALLOWED FOR EACH, AND THE IDENTIFICATION OF THE PARTY TO BE NAMED AS RESPONDENT

A taxpayer has two options after receiving a Commission final decision:

Option 1: PETITION FOR REHEARING BEFORE THE COMMISSION

The taxpayer has a right to petition for a rehearing of a final decision within 20 days of the service of this decision, as provided in Wis. Stat. § 227.49. The 20-day period commences the day after personal service on the taxpayer or on the date the Commission issued its original decision to the taxpayer. The petition for rehearing should be filed with the Tax Appeals Commission and served upon the other party (which usually is the Department of Revenue). The Petition for Rehearing can be served either in-person, by USPS, or by courier; however, the filing must arrive at the Commission within the 20-day timeframe of the order to be accepted. Alternately, the taxpayer can appeal this decision directly to circuit court through the filing of a petition for judicial review. It is not necessary to petition for a rehearing first.

AND/OR

Option 2: PETITION FOR JUDICIAL REVIEW

Wis. Stat. § 227.53 provides for judicial review of a final decision. Several points about starting a case:

1. The petition must be filed in the appropriate county circuit court and served upon the Tax Appeal Commission and the other party (which usually is the Department of Revenue) either in-person, by certified mail, or by courier, within 30 days of this decision if there has been no petition for rehearing or, within 30 days of service of the order that decides a timely petition for rehearing.
2. If a party files a late petition for rehearing, the 30-day period for judicial review starts on the date the Commission issued its original decision to the taxpayer.
3. The 30-day period starts the day after personal service, or the day we mail the decision.
4. The petition for judicial review should name the other party (which is usually the Department of Revenue) as the Respondent, but not the Commission, which is not a party.

For more information about the other requirements for commencing an appeal to the circuit court, you may wish to contact the clerk of the appropriate circuit court or, the Wisconsin Statutes. The website for the courts is *https://wicourts.gov*.

This notice is part of the decision and incorporated therein.