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SIGNIFICANT TAX LAW DEVELOPMENTS IN OREGON
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I. LEGISLATIVE DEVELOPMENT HIGHLIGHTS

The 73rd Legislative Assembly adjourned on August 5, 2005. A special session convened on April 20, 2006. The regular session of the 74th Legislative Assembly convened on January 8, 2007, and adjourned on June 28, 2007. Some of the tax measures that have been enrolled are described below.

A. LEGISLATIVE CHANGES

1. SB 39: Listed Transactions and Reportable Transactions

SB 39 adds provisions to the existing statute governing tax compliance. New provisions provide definitions for listed transactions and reportable transactions for purposes of Oregon income tax. These transactions are defined primarily by reference to Section 6707A of the Internal Revenue Code of 1986 (the “Code”) but also include certain REIT and RIC transactions without economic substance engaged in by Oregon taxable corporations.

The bill identifies persons who must report reportable transactions and empowers the Department of Revenue to adopt rules to implement this reporting requirement. The bill also provides a penalty for failure to report, applicable to tax years beginning on or after January 1, 2007. There is also a penalty for an understatement with respect to a listed transaction discovered in 2008 or later and for promoting a tax shelter, both of which apply to tax years beginning on or after January 1, 1999.

Finally, where use of a listed transaction results in underpayment of tax, the bill provides that the Department of Revenue may give the taxpayer notice of that deficiency at any time within nine years after the return was filed. The bill took effect on September 27, 2007.

2. SB 176: Transfer of Tax Liability to Certain Successor Entities

This bill was enacted to address the Department of Revenue’s concern about the situation in which a small business operates without paying state taxes (e.g., cigarette taxes) then dissolves and reopens as an ostensibly new entity (a “reorganized business entity”).

The bill defines reorganized business entity as an entity:

- a. that was converted from a different form of business entity or has changed ownership;
- b. the predecessor of which incurred an unpaid liability for Oregon taxes, interest, or penalties; and
- c. that operates substantially the same business as the predecessor entity.

The definition of reorganized business entity does not include an entity that was converted from a different form of business entity or that has changed ownership solely because

of a transfer of assets or because of a transfer of an interest by an investor who has no right to manage the business. This should exempt transferees who pay fair market value as well as unknowing purchasers.

The Department of Revenue may treat an entity as a reorganized business entity on consideration of such nonexclusive factors as the fact that the new entity (i) is operating in the same physical location, (ii) provides the same services or manufactures the same products, and (iii) has one or more of the same directors or officers or owners of an interest as the predecessor that owes the tax.

The bill empowers the Department of Revenue to transfer the predecessor entity's tax liability to the reorganized business entity. It was effective as of September 27, 2007.

3. SB 178: Unitary Business Test

SB 178 changes the definition of "unitary group" for purposes of the corporation excise tax. Under prior law, a unitary group meant "a corporation or group of corporations engaged in business activities that constitute *a single trade or business*." Under this new law, the term "unitary business" is substituted for "a single trade or business."

In addition, the threshold for considering a business unitary has been lowered. Under prior law, there were three criteria for finding a unitary business:

- a. centralized management or a common executive force;
- b. centralized administrative services or functions resulting in economies of scale; and
- c. flow of goods, capital resources or services demonstrating functional integration.

Under prior law, all three criteria had to be met. Under SB 178, only one of the three must be met.

The bill was effective as of September 27, 2007 and applies to tax years beginning on or after January 1, 2007.

Because the prior conjunctive version of the test was derived from the U.S. Supreme Court's decision in *Mobil Oil Corp. v. Vermont*,¹ it is uncertain whether this newly enacted disjunctive version of the test will survive challenge in Oregon courts.

¹ "In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. *Butler Bros. v McColgan*, 315 US, at 508-509.... Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for

4. SB 1036: School District Construction Tax

This bill permits a school district to impose a privilege tax to pay for capital improvements. The tax is imposed on improvements to real property, at a rate not to exceed \$1 per square foot on residential-use structures and \$0.50 per square foot on non-residential-use structures, the latter subject to a \$25,000 cap. (Beginning June 30, 2009, the limitation amounts will be indexed to changes in the averaged monthly construction cost index.) The tax is to be paid by the person who undertook the construction of the taxable structure at the time the construction permit was authorized. Certain structures, such as private schools, religious facilities, and hospitals, are exempt.

The district board of the taxing school district must first adopt a long-term facilities plan for making capital improvements before adopting a resolution to impose the construction tax. The school district may pledge the construction tax revenues to secure financing of the capital improvements.

The bill was effective as of September 27, 2007.

5. HB 2007: Recognition of Same-Sex Partnerships

HB 2007 extends to same-sex partners who register their “domestic partnership” with the state all the rights and responsibilities of married people under Oregon law. Domestic partnership is defined as “a civil contract entered into in person between two individuals of the same sex who are at least 18 years old, otherwise capable, and at least one of whom is an Oregon resident.”

The bill does not require a solemnization ceremony but provides instead for a declaration form to be signed and notarized, a public registry of declarations, as well as procedures for separation, annulment, and dissolution. In addition, the prohibitions with respect to bigamy, degree of blood relationship (except for first cousins by adoption), and lack of capacity that apply to marriage also apply to domestic partnerships.

The recognition of domestic partnerships applies as if federal income tax law recognized domestic partnership in the same manner as Oregon law. Because Oregon personal income taxation is based on federal income taxation, this has the effect of eliminating the differences between state taxation of married couples and domestic partners.

The bill will be effective as of January 1, 2008.

6. HB 2210: Biomass and Biofuel Tax Credits

The legislature enacted this bill generally to encourage a renewable biofuel industry and to set standards for biofuels. In addition, once biofuel production reaches certain capacity

purposes of state taxation it is not constitutionally required.” *Mobil Oil Corp. v. Vermont*, 445 US 425, 438 (1980).

milestones, producers will be guaranteed a market by provisions requiring dealers to sell fuel containing minimum percentages by volume of biofuel.

The bill allows both an individual and a corporate income tax credit to an agricultural producer or biomass collector for biomass that is used in Oregon as biofuel or to produce biofuel. These tax credits may be transferred for consideration to another taxpayer, and unused tax credits may be carried forward for four years.

In addition, a resident individual is allowed a credit against personal income taxes for costs related to the purchase of (i) fuel blends for use in an alternative fuel vehicle, (ii) solid biofuel containing 100 percent biomass, or (iii) fuel for primary home space heating that is at least 20 percent biodiesel. These credits are available to nonresidents in a pro-rated amount representing the ratio of costs sourced to Oregon to total costs of the same kind. Eligible individuals who would be allowed to file joint returns but who file separately may each claim a share of the credit based on his or her proportional contribution.

This bill was effective as of September 27, 2007.

7. HB 2235: Updated Connection to the Internal Revenue Code

HB 2235 updates the connection of Oregon laws to the Code as amended and in effect on December 31, 2006. It specifically incorporates the effective and applicable dates, and the exceptions, special rules, and coordination with the Code relative to those dates, contained in the Deficit Reduction Act of 2005 (Pub. L. No. 109-171), the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222), and the Pension Protection Act of 2006 (Pub. L. No. 109-280).

The changes in Oregon state taxation due to the update apply to transactions or activities occurring on or after January 1, 2007 for tax years beginning on or after January 1, 2007. Refunds for tax years beginning before January 1, 2007 that are attributable to any retroactive treatment under the update will not carry interest. With respect to deficiencies assessed for tax years beginning before January 1, 2007 that are attributable to any retroactive treatment under the update, any interest or penalty will be canceled. The bill took effect on September 27, 2007.

8. HB 2236: Property Tax Refund During Pendency of Appeal

Under Oregon law, the county governing body must pay interest on the amount of a property tax refund at a rate of one percent a month or fraction thereof computed from the later of the time the tax was paid or the time the first installment was due. HB 2236 enables the tax collector to refund property taxes in order to stop the accrual of interest during the pendency of an appeal.

Under this bill, a refund may be paid where the following three factors are present:

- a. the county board of property tax appeals or the Oregon Tax Court issues a decision that could result in a refund if upheld on appeal;

- b. the final resolution is pending further appeal; and
- c. the county orders a refund of the tax at issue.

If the final resolution of the controversy after appeal results in a refund, interest will be calculated taking into consideration the amount already refunded under this bill. The fact that a refund is made may not be considered by the decision maker when determining the property value or tax liability being appealed.

The bill applies to appeals relating to property tax years beginning after June 30, 2007, and to property tax appeals pending final resolution on the effective date of the bill, September 27, 2007.

9. HB 2592: Tax Withholding on Conveyances of Real Property Interests

HB 2592 applies to conveyances of interests in real property located in Oregon. “Conveyance” is broadly defined as the sale, lease, encumbrance, mortgage, or creation of a secured interest in real property. Any authorized agent who provides closing and settlement services for the benefit of one of the parties and who receives or disburses moneys in connection with the conveyance must withhold for Oregon personal or corporate income tax where the transferor is (i) a non-resident individual on both the closing date and the date of disbursement, or (ii) a C corporation that, immediately after the conveyance, is not doing business in Oregon. Employees of title companies providing these services are likely to constitute the majority of authorized agents.

Withholding is not required where the authorized agent obtains a written form of affirmation executed under penalties of perjury by the transferor certifying that: (i) the consideration for the property interest is \$100,000 or less; (ii) the transferee is acquiring the property interest through foreclosure; (iii) the individual transferor is an Oregon resident; (iv) the corporate transferor has a permanent place of business in Oregon; or (v) the transferor has professionally competent knowledge or advice that the transferor will not owe tax on the conveyance (A) pursuant to the provisions of the Code deferring tax in the case of like-kind exchanges or involuntary conversions or (B) because the transaction is nontaxable under Oregon law.

Where withholding is required, the authorized agent must withhold the least of (i) 4 percent of the consideration, (ii) 4 percent of the net proceeds, or (iii) 10 percent of the gain includible in taxable income.

The bill applies to conveyances of real property interests on or after January 1, 2008.

10. HB 2707: Oregon Rainy Day Fund

Oregon law includes a “corporate kicker,” i.e., a requirement that the state credit corporate taxpayers with all state corporate income and excise tax revenues exceeding

projections for the legislative biennium by more than 2 percent. In 2006, it was projected that the 2005–2007 corporate kicker would credit approximately 67 percent of taxes paid to corporate excise and income taxpayers. HB 2707 increases the estimate of revenues from corporate income and excise taxes to \$975 million for the 2005–2007 biennium in the expectation that this will eliminate the need to return the kicker. If actual corporate income and excise tax revenues exceed this higher estimate by 2 percent or more, the corporate kicker will be returned to taxpayers according to the usual statutory mechanism.

In addition, the bill establishes the Oregon Rainy Day Fund as an account in the state's General Fund. Included are procedures for payment into the Fund and for legislative appropriation from the Fund to make up projected shortfalls in the General Fund.

The bill was effective as of May 1, 2007.

Related Enactments:

11. HB 2031: This bill effectively reinstates the corporate kicker for small C corporations as it would have been computed before the estimate for the 2005–2007 biennium was raised to \$975 million by HB 2707 (*see above*). It allows a 67 percent credit against taxes otherwise due to C corporations with Oregon sales of less than \$5 million for the corporation's tax year beginning on or after January 1, 2007 and before January 1, 2008.

12. SB 819: This bill changes the calculation of both the corporate and personal kickers so that the amount of credit or refund will be determined before any other income tax credits are applied.

13. HB 3048: This bill changes the base year on which the corporate kicker is computed and provides for carry-forward of unused kicker credits.

All three bills were effective as of September 27, 2007.

II. ADMINISTRATIVE DEVELOPMENT HIGHLIGHTS

A. ADOPTED RULES.

1. Penalty Waivers: OAR 150-305.145(4), effective July 31, 2007, applies to taxpayers that do not believe a tax penalty has been improperly imposed on them and that nonetheless seek waiver. Penalties eligible for waiver include the 5, 25, 50, and 100 percent failure-to-file penalties and the 5 percent failure-to-pay penalty. The Department of Revenue will waive any eligible penalty for any tax program if the taxpayer failed to file or pay because of circumstances beyond the taxpayer's control. The Department of Revenue will also consider waiver of 5 or 25 percent penalties on a one-time basis if the taxpayer has not received relief under this provision before. Payroll tax penalty waivers are subject to higher standards than penalties for other tax programs.

2. Sourcing of Tangible Personal Property, Including Electricity and Natural Gas: OAR 150-314.665(2)-(C), effective July 31, 2007, establishes a delivery rule for sourcing tangible personal property, including, but not limited to, electricity and natural gas, for purposes of determining the Oregon sales factor. Gross sales include all electricity delivered in Oregon, including offsetting amounts purchased by two entities from each other.

3. Sales of “Off the Shelf” and Custom Software: Under OAR 150-314.665(3), effective January 1, 2007, for purposes of computing the sales factor, sale of commercial, off the shelf software (a/k/a COTS) is a sale of tangible personal property, whereas sale of customized software is a sale of a service. Database services are a combination of tangible property (i.e., freestanding software necessary to access on-line information) and a service. Sale of the service is allocated to the state in which the majority of the cost of performance occurs.

4. Direction-and-Control Requirement for Independent Contractors: The three requirements for treating a worker as an independent contractor are found in ORS 670.600. The text of OAR 150-670.600, effective February 1, 2007, focuses on the requirement that an independent contractor be “free from direction and control over the means and manner of providing the labor or services.” The Department of Revenue and the other state agencies that have adopted this rule will interpret the direction-and-control requirement to mean that an independent contractor must:

- a. determine which resources to use in order to perform the work, and how to use them;
- b. determine how to perform the work, including, for example, work schedules, processes, and procedures; and
- c. be free from the right of the person for whom services are provided to control the means or manner of providing the services, whether that person actually exercises the right of control.

The fact that the person for whom services are provided has the right to specify the final desired results of the worker’s services does not constitute direction and control over the means or manner of providing the services.

B. AMENDED RULES.

1. Definition of Tangible Personal Property: The definition of tangible personal property has been imported from the Multistate Tax Commission Streamlined Sales Tax Agreement into OAR 150-314.665(2)-(A) for purposes of determining the Oregon sales factor. (Oregon does not have a sales or use tax.) Tangible personal property means personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses, and includes electricity, water, gas, steam, and prewritten computer software.

2. Sales Other Than Sales of Tangible Personal Property: OAR 150-314.665(4) is amended to include franchising among the listed uses of property that are income-producing

activities for purposes of determining the sales factor. Intangible personal property is now located in Oregon if it is used in business activity in Oregon, whether by the taxpayer, a third-party licensee, or another entity with the right to use the property. Intangible personal property may be used in more than one state at the same time, and each use in a separate state is considered a separate income-producing activity.

3. Claim of Right Computations: The additions to OAR 150-315.068 state that where income that was recognized under the claim of right provisions must be repaid in a later Oregon taxable year, the taxpayer's federal adjusted gross income, federal taxable income, and federal tax must be recomputed under Section 1341 of the Code prior to recomputing its Oregon tax liability.

4. Fringe Benefits Provided to Domestic Partners: Under amended OAR 150-316.007-(B), the imputed value of certain fringe benefits provided by an employer to an employee's same-sex domestic partner is exempted from state income tax.

5. Minimum Corporate Tax: OAR 150-317.090 has been amended to provide that the minimum tax of an affiliated group of corporations filing a consolidated return will be computed as the \$10 minimum tax multiplied by the number of corporations in the group doing business in Oregon. The amended rule is effective for tax years beginning on or after January 1, 2006.

C. PROPOSED RULES.

1. Substantial Nexus: For purposes of corporate excise and income tax jurisdiction under the commerce clause of the U.S. Constitution, the Department of Revenue has proposed OAR 150-317.010 for determining when a taxpayer has substantial nexus with Oregon. The dimensions of the rule include the following:

- a. The taxpayer does not have to have a physical presence in Oregon.
- b. Substantial nexus exists where a taxpayer regularly takes advantage of Oregon's economy to produce income.
- c. Substantial nexus may be established through significant economic presence in Oregon.
- d. To determine whether a taxpayer has a significant economic presence in Oregon, the Department of Revenue may consider the following non-exclusive factors:
 - (1) maintenance of continuous and systematic contacts with Oregon's economy or market;
 - (2) deliberate marketing to, or solicitation of, Oregon customers;

- (3) filing of reports or returns with Oregon regulatory bodies;
- (4) significant gross receipts from Oregon customers;
- (5) significant gross receipts attributable to the use of the taxpayer's intangible property in Oregon; and
- (6) receipt of benefits provided by the state (e.g., laws protecting property rights, the judicial system, transportation, etc.).

III. CASELAW DEVELOPMENT HIGHLIGHTS

A. PROCEDURAL ISSUES.

1. Tax Court Regular Division Limited to Abuse of Discretion Review of Case Dismissed in Magistrate Division Due to Procedural Defect.

Freitag v. Department of Revenue, TC 4737 (October 4, 2006).

The Regular Division of the Oregon Tax Court held that it was limited to abuse of discretion review of a case dismissed by the Magistrate Division due to a procedural defect.

The taxpayers appealed the value of real property to the Magistrate Division. The county failed to appear at the case management conference, but the magistrate nonetheless allowed the appeal to go forward. The taxpayers, however, did not respond to the magistrate's request for a submission of three dates for trial, and the magistrate dismissed the appeal for lack of prosecution.

On appeal, the Regular Division noted that, under ORS 305(425)(1), in general, all proceedings in the Tax Court are to be tried *de novo*. The court held, however, that ORS 305.501(3), the statute requiring rules of procedure to be established in the Magistrate Division, would be rendered meaningless unless it is read as limiting the Regular Division to abuse of discretion review of cases dismissed below for a procedural defect.

The judge then reviewed the dismissal but not the merits of the taxpayer's appeal. He noted that the magistrate had the statutory authority to apply sanctions where a party refuses to comply with the court's directives. The taxpayers testified that their refusal was justified because the schedule set by the magistrate was inconsistent with the schedule they wanted. The judge reasoned that the notion that the magistrate, rather than the litigants, governs the proceedings is implicit in the grant of power to the Magistrate Division. Therefore, it was not an abuse of discretion for the magistrate to allow the proceeding to go forward after the county failed to appear or to dismiss the appeal due to the taxpayers' lack of prosecution.

B. CORPORATION EXCISE TAX ISSUES.

1. Statutory Protections Adequate for Department of Revenue’s Lawful Sharing of Taxpayer’s Confidential Information.

Harley-Davidson, Inc. v. Department of Revenue, No. TC-MD 040897A (December 21, 2006).

The Magistrate Division denied a motion for a protective order with respect to the Department of Revenue’s discovery requests because the plaintiff’s confidential information was adequately protected by ORS 314.840, the statute authorizing limited disclosure of information set forth on tax returns and otherwise protected from disclosure by ORS 314.835, and because the department’s lawful sharing of information could not annoy, embarrass, or oppress plaintiff under the Tax Court’s discovery rules.

Harley-Davidson appealed corporation excise tax assessments to the Tax Court, contending that, pursuant to Public Law 86-272, its activities in Oregon were not taxable here. It unsuccessfully resisted the Department of Revenue’s requests for production which were made in order to resolve factual issues, and so it moved for a protective order.

The magistrate held that its decision was governed by Tax Court Rule 36.C, which authorizes the court to limit discovery to protect a party from annoyance, embarrassment, oppression, or undue burden or expense. (Only the first three criteria were relevant here.) The magistrate accepted the defendant’s statement that, under its broad view of ORS 314.835(1), it treated as confidential all documents containing information used to prepare returns. The department sought limited disclosure under ORS 314.840, pursuant to its reciprocal exchange agreements with other states and the Multistate Tax Commission. It also intended to keep the information to review and use in determining Harley-Davidson’s tax liability for other tax years.

The court rejected the plaintiff’s distinction that the department was not obtaining information pursuant to statutory authority but by court order during the discovery phase of its appeal. The magistrate stated that the legislature had conferred the authority to obtain and share confidential information within the parameters of ORS 314.840, and there was no reason to limit that authority simply because the information was obtained during discovery. The magistrate held that ORS 314.840 provided adequate protections and the plaintiff could not as a result experience annoyance, embarrassment, or oppression through the Department of Revenue’s intended lawful sharing of the taxpayer’s confidential information.

2. Department of Revenue’s Alternate Apportionment Formula Void Because Taxpayer’s Returns Prepared in Accordance With Standard Formula Prescribed by Department.

US Bancorp v. Department of Revenue, No. TC 4351 (March 13, 2007).

The Oregon Tax Court held that OAR 150-314.280-(M) (“Revised M”), the alternate apportionment rule applicable to financial institutions, could not serve as authority for the Department of Revenue to adjust the taxpayer’s returns which had been prepared in accordance with the standard formula prescribed by the department itself. Moreover, even assuming the rule

could serve as authority for the department's adjustment, the department improperly applied the rule by failing to determine first whether, in the language of its rule, the taxpayer's application of the standard apportionment formula did not fairly and accurately reflect the net income of the business done within Oregon, based on the taxpayer's business activity within Oregon.

The taxpayer filed its Oregon corporation excise tax returns for the years at issue by applying the standard three-factor apportionment formula prescribed by the Department of Revenue for financial organizations. On audit, the department determined that including the taxpayer's intangible personal property in the apportionment formula resulted in a more accurate allocation of net income to Oregon.

The department took the position that Revised M and the statute under which it was promulgated empowered an individual auditor to make a decision that fair and accurate apportionment required inclusion of intangible property. The court noted that this position contradicted the department's rule OAR 150-314.280-(E) and further reasoned that it was nonsensical to authorize the Department of Revenue to make the detailed formula rules under ORS 314.280 in the first instance only to permit it to abandon them on its own motion. The court rejected the department's "ad hoc" position, holding that Revised M and the statute are consistent only with a process in which a taxpayer proposes changes to pre-established apportionment methods promulgated by the Department of Revenue.

The court then held that even if the department could include intangibles in the taxpayer's property factor under Revised M, the key prerequisite for any adjustment was a finding that the original return, filed in accordance with the department's other rules, was not fair and accurate. If the returns were not fair and accurate, then the department's adjustments *might* be proper; otherwise, those adjustments were clearly improper. The court rejected the department's claim that Revised M gave it authority to require an adjustment whenever it decided that the adjustment would render the taxpayer's return *more* fair and accurate as being unsupported by the text of Revised M or any other source of law. Finding that the department's formulae increased the taxpayer's tax liability by less than 15 percent, the court held that the taxpayer's apportionment was fair and accurate within the meaning of Revised M and the adjustments required by the department were void.

3. Payments of Judgment Under Indemnification Agreements Were Expenses Attributable to Business Income Under Transactional Test.

U-Haul Co. of Oregon v. Department of Revenue, No. TC-MD 030994B (August 29, 2007).

The Magistrate Division granted plaintiff's motion for summary judgment, holding that payments made by the taxpayer's common parent were expenses attributable to business income for purposes of Oregon corporation excise tax.

Plaintiff U-Haul Co. of Oregon was a wholly owned second-tier subsidiary of AMERCO, a Nevada corporation, and a member of its unitary group for Oregon tax purposes. After a suit was filed by minority shareholders of AMERCO against certain directors for breach of fiduciary

duty, among other claims, AMERCO entered into separate indemnification agreements with each director who was also a defendant in the suit. (AMERCO was joined in the suit as a defendant but dismissed before the case went to the jury.) A monetary judgment was entered against the director-defendants and AMERCO entered into a settlement agreement with them whereby it satisfied the judgment in return for their release of AMERCO from its obligations under the indemnification agreements. AMERCO distinguished between payments for the acquisition of the plaintiffs' stock and payments for damages, deducting the latter as ordinary and necessary business expenses under Section 162 of the Code. The plaintiff treated the payments as expenses attributable to business income, which gave rise to Oregon NOLs for the tax years at issue. The Department of Revenue disagreed with this treatment and issued an assessment of tax due, which the taxpayer appealed to the Oregon Tax Court.

The sole issue before the court was whether AMERCO's payments were expenses attributable to business income for purposes of Oregon corporation excise tax. Under ORS 314.610(1), income may be characterized as business income under either the transactional test or the functional test. The court held that the payments were made in lieu of the directors seeking additional remuneration or filing additional litigation to secure the indemnification due them under the contracts. The court thus agreed with the plaintiff that the transactions that gave rise to the payments were the indemnification agreements between AMERCO and the director-defendants.

The second question under the transactional test was whether AMERCO made the payments in the regular course of its business. Because the costs associated with indemnification are a common and recognized cost of doing business as a corporation, the magistrate held that the payments arose in the regular course of AMERCO's business. The payments indemnifying the director-defendants were thus expenses attributable to business income.

C. PERSONAL INCOME TAX ISSUES.

1. Non-Oregon NOL Disallowed by Oregon Must Be Restored to Federal Basis Before Computing Oregon Income Tax.

Foote v. Department of Revenue, No. TC-MD 050432C (November 14, 2006).

The Magistrate Division held that the plaintiff could not be taxed by reference to a federal adjusted basis in a wholly owned S corporation that had been reduced for losses disallowed by Oregon. The taxpayer's Oregon personal income tax had to be recalculated by reference to a basis to which the disallowed losses had been restored.

While the taxpayer resided in California, his wholly owned S corporation realized an NOL. The taxpayer moved to Oregon where the Department of Revenue disallowed application of the California NOL carry-forward against Oregon income. The Department of Revenue denied the taxpayer's refund of personal income taxes and determined that he instead owed tax. The taxpayer appealed to the Tax Court.

The Tax Court addressed the question of whether the non-Oregon source losses had to be restored to the taxpayer's federal basis in the S corporation pursuant to ORS 316.716(1)(e) and the principles enunciated in *Zemke v. Department of Revenue*, 17 OTR 18 (2003). The court stated that the statute was unclear, but held that the legislative history revealed an intent that there be an adjustment to federal taxable income where there is a difference in basis because of a difference between federal and Oregon tax law. The statute embodied the tax benefit rule and applied to the taxpayer's case. Read otherwise, as the court stated in *Zemke* (in the context of adjustments to basis for depreciation), Oregon would gain the benefit of the basis reduction to property produced by the out-of-state loss deductions but would never permit the deductions to yield a tax benefit to the taxpayer.

D. PROPERTY TAX ISSUES.

1. Partial Allowance of Charitable Exemption from Property Taxation.

Goodwill Industries of the Columbia Willamette, Inc. v. Benton County Assessor, No. TC-MD 060676D (April 18, 2007).

The Magistrate Division held that 35 percent of an Oregon donation center leased by Goodwill Industries of the Columbia Willamette, Inc. ("Goodwill"), a Section 501(c)(3) corporation, was actually and exclusively used in the organization's charitable work and was thus exempt from property taxation in the same proportion.

Goodwill operated a retail center that was granted exemption from property taxation. It then changed the property's use to a donation site and the Department of Revenue denied the continuation of the exemption because of an insufficient level of charitable activity conducted there. Plaintiff appealed to the Tax Court.

The court first addressed the question of whether Goodwill's use of the property met the three required elements of a charitable organization under Oregon law: (i) that the organization have charity as its primary object; (ii) that its activities at the site further its charitable objective; and (iii) that its conduct at the site, viewed from the perspective of the recipient, involve a degree of giving. The taxpayer's use of the donation center met all three criteria. The court next determined that, while the property was exclusively used in the taxpayer's charitable work, its actual use was limited to 35 percent of the site and thus qualified for a 35 percent partial exemption from property taxation.