Oregon Tax Court to Department of Revenue: "You Can't Have Your Cake and Eat It Too!"

By Kirk R. Lyda and Justin Thompson[1]

Kirk Lyda and Justin Thompson examine a recent ruling where the Oregon Tax Court found that gains from the sales of stock of two subsidiaries were business income and were includable in the taxpayer's sales factor denominator for Oregon corporation excise tax purposes.

The Oregon Tax Court recently determined that while the proceeds from sales of subsidiary stock constituted apportionable business income for purposes of computing Oregon corporate excise tax liability, the gain proceeds from the sales were similarly business receipts that must be apportioned fairly. Thus, the Oregon Department of Revenue (the "Department") could not exclude such proceeds from the denominator of the Oregon sales factor.[2]

Gains, Gains and More Gains

Oracle Corporation ("Oracle") is a Delaware corporation with its principal place of business in California. Oracle is engaged primarily in the development, manufacturing, marketing and distribution of information management software. Prior to 1999, Oracle held stock in two subsidiaries, Oracle Corporation Japan[3] ("Oracle Japan") and Liberate Technologies, Inc. ("Liberate"). In February 1999 and April 2000, Oracle caused its subsidiaries to sell stock in Oracle Japan and as a result realized gains of $24 million and $6.4 billion, respectively, on its federal consolidated corporate income tax return. Likewise, in February 2000 and October 2000, Oracle sold its stock in Liberate and realized gains of $441 million and $31 million, respectively, for federal income tax purposes. Oracle excluded all of these gains in computing its Oregon taxable income for tax years ending May 31, 1999, May 31, 2000 and May 31, 2001. It took the position that such gains were unrelated to its business activities in Oregon.

The Department adjusted Oracle's corporate excise tax returns to include the aforementioned gains and issued notices of assessment for the 1999, 2000 and 2001 tax years in an amount totaling approximately $5.17 million plus $2.6 million in interest.

Includable or Not?

During the period at issue, Oregon utilized the three-factor apportionment formula of the Uniform Division of Income for Tax Purposes Act (UDITPA) to calculate Oregon taxable income. Under Oregon law, "business income" is "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible

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property if the acquisition, management, use or rental, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."[4] Business income is multiplied by the three-factor formula (property, payroll and sales) to arrive at Oregon taxable income. With respect to the sales factor, sales exclude "gross receipts arising from the sale . . . of intangible assets, . . . unless those receipts are derived from the taxpayer's primary business activity," but include "net gain from the sale . . . of intangible assets not derived from the primary business activity of the taxpayer but *included in the taxpayer's business income*."[5]

Oracle Japan

Oracle initially challenged the Department's classification of the gains from the sales of stock in Oracle Japan as business income. During the pendency of the litigation, however, the Oregon Tax Court issued two opinions in which it held that the gains on sales of certain intangible assets (an FCC license and subsidiary stock) constituted business income under Oregon's functional test for classifying income.[6] Thereafter, Oracle elected not to litigate whether the sales of Oracle Japan stock constituted business income.

In addition to characterizing the gains as business income, the Department excluded the gains from the denominator of Oracle's sales factor for the years in question, arguing that under ORS §314.665(6)(a), the gains were not derived from Oracle's primary business activity. Oracle countered that the Department could not conclude that the acquisition, use and disposition of the stock constituted integral parts of Oracle's regular trade or business operations for one purpose (*i.e.*, characterization as business income) but not for another (*i.e.*, exclusion from the sales factor). The court agreed with Oracle and held that the gains from the sales of Oracle Japan's stock should be included in the denominator of Oracle's sales factor under ORS §314.665(6)(b).

During the period at issue, Oregon utilized the three-factor apportionment formula of the UDITPA to calculate Oregon taxable income.

Liberate

With respect to the sales of Liberate stock, Oracle argued that the gains did not constitute apportionable business income because, at the time of sale, Oracle and Liberate were not unitary, and Oracle did not hold the Liberate stock as part of its unitary business. Liberate went public in July 1999, just prior to Oracle's stock sales in 2000. Oracle contended that following the initial public offering, it held the Liberate stock for investment rather than operational purposes.

The court rejected Oracle's arguments, finding that Oracle and Liberate were unitary at least through the 1999 initial public offering (and likely thereafter), given Oracle's majority ownership interest in Liberate, common directors and related-party transactions. Furthermore, the court concluded that the gains from the sales of Liberate stock met the functional test for classification as business income.

Finally, the court determined that the Liberate gains should be included in the denominator of Oracle's sales factor for the same reasons that the Oracle Japan gains were so included.

Endnotes

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2 *Oracle Corp. v. Or. Dep't of Rev.*, TC-MD 070762C, [Or.] St. Tax Rep. (CCH) ¶401-012 (Jan. 19, 2012).

3 Oracle held stock in Oracle Japan through two intermediate subsidiaries, Oracle Japan Holding, Inc. and Oracle International Investment Corp.

4 Or. Rev. Stat. ("ORS") §314.610(1).

5 ORS §314.665(6)(a)–(b) (emphasis added).

6 *See Crystal Commc'ns, Inc. v. Or. Dep't of Rev.,* TC 4769, [Or.] St. Tax Rep. (CCH) ¶400-953 (July 19, 2010); *CenturyTel, Inc. v. Or. Dep't of Rev.,* TC 4826, [Or.] St. Tax Rep. (CCH) ¶400-955 (Aug. 9, 2010).