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OREGON STATE BAR

Taxation Section

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2013 Oregon Legislative Sessions: Tax Law Developments

By Eric J. Kodesch and Elisabeth S. Shellan[1]

The 2013 regular Oregon legislative session adjourned sine die on July 8, 2013. During the session, there were hopes that a "grand bargain" could be reached consisting of implementing cost and benefit reductions to Oregon's public employees retirement system (PERS), increasing funding of education, and adopting tax changes. This never materialized during the regular session, but it was accomplished during a special legislative session held between September 30, 2013 and October 2, 2013. Certain of the tax provisions of the special session and the regular session are summarized in this article.

Special Session

Reduced Oregon Tax Rate on Nonpassive Flow-Through Income from Partnerships and S Corporations

For tax years beginning on or after January 1, 2015, taxpayers subject to the Oregon personal income tax may elect to have nonpassive income attributable to any partnership or S corporation (after reduction for nonpassive losses) taxed at the following rates:

If income is more than	But not more than	The tax rate is
----	$250,000	7.0%
$250,000	$500,000	7.2%
$500,000	$1,000,000	7.6%
$1,000,000	$2,500,000	8.0%
$2,500,000	$5,000,000	9.0%
$5,000,000	----	9.9%

- The term "partnership" includes a limited liability company (LLC) or other entity taxed as a partnership. However, the new reduced rates will not apply to a single-member LLC that is disregarded as an entity separate from its owner. As a result, Schedule K-1 income reported on Schedule E generally will receive more favorable tax treatment than either Form W-2 wage income or income from a sole proprietorship (including from a single-member LLC) reported on Schedule C.
- "Nonpassive income" is as defined in the Internal Revenue Code and does not include wages, interest, dividends or capital gains. In calculating the amount of income not subject to the special rates, taxpayers must use the subtractions, deductions and additions otherwise allowed. On the other hand, in calculating the amount of income subject to the special rates, depreciation adjustments directly related to the partnership or S corporation are the only additions or subtractions allowed.
- A taxpayer can elect to use the alternative rates only if: (1) the taxpayer materially participates in the day-to-day operations of the trade or business; (2) the partner-

1 Eric J. Kodesch is a partner and Elisabeth S. Shellan is an associate at Stoel Rives LLP in Portland, Oregon. The authors thank Robert T. Manicke and Christopher K. Heuer for their assistance with this article.

ship or S corporation employs at least one person who is not an owner, member or limited partner of the partnership or S corporation; and (3) those non-owner employees perform at least 1,200 aggregate hours of work in Oregon by the close of the tax year, taking into account for this purpose only hours worked by an employee in weeks in which the employee works at least 30 hours.

- A nonresident may apply the reduced rates only to "income earned in Oregon." A part-year resident must calculate the tax due using the reduced rates by first applying those rates to the taxpayer's qualifying nonpassive income, and then multiplying that amount by the ratio of the taxpayer's nonpassive income in Oregon divided by nonpassive income from all sources. A nonresident joining in the filing of a composite return is not eligible for the reduced rates.
- The bill directs the Legislative Revenue Officer to calculate projected and actual ratios of revenue loss to total state income. To the extent the actual ratios deviate from the projected ratios by specified thresholds, the special tax rates will be adjusted for tax years beginning after 2018 and again after 2022.

Change in the Oregon Corporation Excise Tax Brackets

For tax years beginning on or after January 1, 2013, the Oregon corporation excise tax brackets have been changed so that the 7.6% top marginal rate applies to taxable income in excess of $1 million, rather than taxable income in excess of $10 million. This change also is made to Oregon's parallel corporation income tax, which generally applies to corporations not doing business in Oregon but receiving income from Oregon sources.

Creation of an Oregon IC-DISC Regime

Prior to the special session, Oregon did not conform to the federal tax regime applicable to an IC-DISC. Instead, Oregon law treated an IC-DISC in the same manner as any other corporation and disregarded transactions between a taxpayer and an IC-DISC if the two were related. For tax years beginning on or after January 1, 2013, the new law changes this treatment for IC-DISCs **formed on or before January 1, 2014** (the date HB 3601 takes effect). For these IC-DISCs:

- The Oregon minimum tax does not apply.
- In lieu of regular corporate rates, a special 2.5% tax rate applies to commissions received by the IC-DISC.
- A related taxpayer is allowed a deduction for commissions paid to the IC-DISC.
- The federal taxable income of a shareholder subject to the Oregon personal income tax is reduced by the amount of any dividend paid by the IC-DISC.

It appears that some of the new benefits of the Oregon IC-DISC regime (the 2.5% tax rate and the deduction allowed to a taxpayer) may apply only to commission-based ICDISCs, and not to buy/resell IC-DISCs.

Elimination of Personal Exemption for Higher-Income Taxpayers

Oregon generally provides a personal exemption credit equal to an inflation-adjusted amount (for 2013, $183) multiplied by the number of personal exemptions allowed to the taxpayer. Prior to the special session, the credit was reduced if the taxpayer's income exceeded a threshold amount. For tax years beginning on or after January 1, 2013, the credit has been eliminated for taxpayers whose federal adjusted gross income exceeds $200,000 (for joint return filers, a surviving spouse or a head of household) or $100,000 (for single filers, including married filing separately).

Senior Medical Expense Deduction Means - Testing and Increased Age Threshold

For tax years beginning on or after January 1, 2013, the reduction in Oregon taxable income allowed to seniors for nondeductible medical expenses is phased out for adjusted gross incomes between $100,000 and $200,000 (for joint return filers, a surviving spouse or a head of household) or $50,000 and $100,000 (for single filers, including married filing separately). The minimum age for eligibility will rise incrementally from 62 for 2013 to 66 starting in 2020.

Regular Session

Surviving Revenue Raiser from the First (Failed) Grand Bargain: Deviation from Oregon's Water's Edge Limitation

Many of the revenue raisers for the grand bargain, which were adopted in the 2013 special session, were contained in HB 2456, or proposed amendments to HB 2456. Although the bill ultimately did not pass the legislature, it did result in a minority report that endorsed one of the ideas in HB 2456. Those provisions were moved to HB 2460, which was enacted as Oregon Laws 2013, chapter 707. The new law modifies Oregon's water's edge limitation – the rule that restricts the income and apportionment factors reported on an Oregon consolidated corporation excise tax return to those of the corporate members of the unitary group formed under United States law or otherwise included in a federal consolidated return. Pursuant to the change, an Oregon consolidated corporation excise tax return includes the income and apportionment factors of a unitary foreign corporation formed in any of the following jurisdictions (the "Listed Jurisdictions"):

> Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark-Alderney, the Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, the

Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, the Netherlands Antilles, Niue, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, the Turks and Caicos Islands, the U.S. Virgin Islands and Vanuatu. HB 2460 § 2.

At first blush, it may seem surprising that the only surviving provision of HB 2456 would concern a deviation from a core principle of Oregon corporation excise tax, like the water's edge limitation. After all, creating a water's edge limitation was a primary purpose of the fundamental corporation excise tax reform started in the 1984 special legislative session, modified in the 1985 regular legislative session and ultimately taking effect in 1986. However, the Listed Jurisdictions are countries that are, or are generally perceived to be, foreign tax havens.[2] In addition, the new law is modeled after a Montana tax law that similarly expands a water's edge group to include corporations formed in the Listed Jurisdictions.

Potential issues with the law are summarized in an open letter sent by eight Oregon tax attorneys to the Oregon Senate Finance and Revenue Committee in May 2013. A copy of the letter can be found here.

The new law also imposes reporting requirements on the Oregon Department of Revenue. Specifically, the Department must report to the legislature on (1) recommended changes to the Listed Jurisdictions and (2) the use of out-of-state tax shelters and to make recommendations for addressing noncompliance attributable to out-of-state tax shelters.

Withdrawal and Reenactment of the Multistate Tax Compact

Oregon enacted the Multistate Tax Compact in 1967, which generally allows taxpayers to elect to use equal-weighted, three-factor apportionment based on property, payroll and sales. Oregon also enacted ORS 314.606, which generally provides that when an Oregon statute conflicts with the Multistate Tax Compact, the Oregon statute prevails. Thus, for example, ORS 314.606 would, or was intended to, cause Oregon's adoption of single-factor apportionment to override the ability to use three-factor apportionment.

In *The Gillette Co. v. Franchise Tax Board*, 144 Cal Rptr 3d 555 (App 2012), a California appeals court ruled that a California provision similar to ORS 314.606 did not nullify the ability of a taxpayer to elect equal-weighted, three-factor apportionment pursuant to the Multistate Tax Compact. That decision is currently being appealed to the California Supreme Court in *Gillette Co. v. Franchise Tax Board*, Cal Supreme Ct No. 206587. In addition, there is a case in the Regular Division of the Oregon Tax Court, *Health Net Inc. v. DOR*, Or Tax Ct No. 5127, that raises the same issue as *Gillette* and the Department has provided guidance for filing a protective refund claim based on this issue. This guidance can be found here.

In an attempt to avoid the *Gillette* issue for periods after October 7, 2013, the Oregon legislature enacted Oregon Laws 2013, chapter 407 (SB 307) to withdraw from the Multistate Tax Compact and then reenact it without the provisions applicable to income tax and apportionment of business income for corporate tax purposes.

Retroactive Change and Prospective Repeal of ORS 314.296

In 2009, Oregon enacted ORS 314.296, which generally requires an Oregon taxpayer to add back to income certain expenses paid to a related member for the use of the related member's intangible property. Oregon Laws 2013, chapter 467 (HB 3069) (1) retroactively amends ORS 314.296 so that there is no add back if the related person is a foreign corporation and (2) prospectively repeals ORS 314.296 so that the add back does not apply to tax years beginning on or after January 1, 2013. The authors of this article were involved with the drafting and passage of the law.

Modifications to Senior and Disabled Property Tax Deferral Program

The state of Oregon has a program whereby disabled or senior citizens may "borrow" from the state of Oregon to pay property taxes that they owe to the county. The Senior and Disabled Deferral Program has undergone many changes in the past two legislative sessions spurred, in part, by reporting by the *Oregonian* that the program also benefited individuals who lived in "high-value" homes. Oregon Laws 2011, chapter 723 (HB 2543) made requirements for participation more stringent by, among other things, requiring that the real market values of the homes of the participants be below a threshold ranging from 100% to 200% of the county median real market value. It also prohibited participants from pledging their homes as security for a reverse mortgage and required participants to have lived in their homes for at least five years before participating in the program. Oregon Laws 2012, chapter 13 (HB 4039) granted a two-year reprieve to program participants who had been disqualified from the program solely due to a reverse mortgage and allowed them to participate in the program for the 2011-12 and 2012-13 tax years. The legislature further modified the program during this legislative session.

Oregon Laws 2013, chapter 31 (HB 2489) permanently extends the exception for certain homesteads pledged as security for reverse mortgages, thus allowing continued qualification for deferral.

Oregon Laws 2013, chapter 494 (HB 2510) provides that the five-year minimum requirement and reverse mortgage prohibition do not apply to homesteads that had been granted deferral for any property tax years beginning before July 1, 2011. The provision requires the Department of Revenue to provide notice to individuals with inactive deferral accounts that they may be eligible

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2 This may be an overstatement. For example, among the Listed Jurisdictions is Luxembourg, a founding member of the European Union.

to have their accounts reactivated for property tax years beginning on or after July 1, 2014. The provision requires an application for deferral and limits the number of homesteads reactivated for the 2014-15 tax year to 700, although this limit increases each subsequent year by 5%.

Denial of Deduction for Contributions to Certain Listed Charities

Oregon Laws 2013, chapter 260 (HB 2060) allows the Oregon Attorney General to issue an order disqualifying a charitable organization from receiving contributions that are deductible for purposes of Oregon income tax and corporate excise tax if the Attorney General finds that the charitable organization has failed to expend at least 30% of total annual functional expenses on program services when those expenses are averaged over the most recent three fiscal years. Charitable organizations subject to a disqualification order must disclose that fact in all solicitations made by the organization to persons in Oregon. In addition, the Attorney General must publish on the Internet and otherwise make available a list of charitable organizations that are subject to disqualification orders.

The law requires a donor to add back to Oregon taxable income the amount deducted for a contribution to an entity that received a disqualification order, if the contribution was made more than 30 days after the Attorney General published the order on the Internet. A donor can avoid the add back by providing the Department of Revenue a contribution receipt on which the organization failed to disclose the order.

The law also denies property tax exemption under ORS 307.130 starting with the tax year following the tax year in which the order goes into effect.

The law originated from the Oregon Attorney General's annual "worst charities" list. The 2012 list is available here.

Reconnection to the Internal Revenue Code

Oregon generally is a "rolling reconnect" state, incorporating the Internal Revenue Code, including future amendments, for purposes of defining taxable income. For a variety of other purposes, however, Oregon Laws 2013, chapter 377 (HB 2492) generally updates Oregon's reconnection to the Internal Revenue Code from December 31, 2011 to January 3, 2013. Ordinarily, the reconnection would have been to December 31, 2012, but the legislature chose January 3, 2013 in order to incorporate the provisions of the American Tax Relief Act of 2012.

New Oregon Penalties for Missing, Incomplete or Incorrect Forms 1099 and W-2 and Other Information Returns

Oregon Laws 2013, chapter 734 (HB 2464) imposes Oregon-only penalties for failure to file an information return with the Department of Revenue, or for incomplete or incorrect returns, including Forms 1099 and W-2, and annual and quarterly withholding returns.

Exemption for Power Transmission Property Leased to United States

Oregon Laws 2013, chapter 336 (SB 261) exempts from property taxation certain high-voltage electrical transmission property installed on real property interests of the United States and leased to the United States, if the United States has an option to buy the property for a nominal price following the lessor's payoff of its acquisition debt. The new law retroactively applies to property tax years beginning on or after July 1, 2008 and provides a refund mechanism for taxes paid with respect to prior years.

Deletion of Exemption for Out-of-State Banks

Oregon Laws 2013, chapter 614 (HB 3477) repeals ORS 317.057, which exempted out-of-state banks, extranational institutions or foreign associations that engage in certain activities within Oregon from Oregon fees and taxation. While these entities may lack nexus with Oregon based on their degree of contact with the state, the repeal of the exemption requires examination of the facts in each case.

Increased Tax Court Filing Fees

Oregon Laws 2013, chapter 685 (HB 2562) increases the filing fee for a complaint filed in the Oregon Tax Court from $240 to $252. The fee increase applies to actions commenced on or after October 1, 2013.

The Honorable Henry C. Breithaupt Wins Oregon State Bar Taxation Section Award of Merit

By Peter Evalds[1]

The Honorable Henry C. Breithaupt, Judge of the Oregon Tax Court, has received the Award of Merit by the OSB Taxation Section. The award recognizes and honors the achievements of those who exemplify professionalism in the practice of tax law in Oregon. Said Dan Eller, former judicial clerk to the court, "We are lucky to have a specialized tax court in Oregon, and particularly lucky to have him as the judge. He is a smart, intelligent person who cares about the rule of law and always exhibits a high degree of professionalism." Judge Breithaupt expressed gratitude for the wonderful mentors and professional colleagues that have helped him over the years.

About the Judge

Judge Breithaupt graduated Phi Beta Kappa from Pomona College in Claremont, California in 1970. He

1 Peter Evalds is a student (3L) at Lewis & Clark Law School (JD, Tax Cert., expected Jan. 2014); Peter currently is a Law Clerk at Holland & Knight LLP, and will be a Judicial Clerk for the Oregon Tax Court in 2014–2016.

went on to attend the University of Oregon School of Law, graduating first in his class in 1975 and becoming a member of the prestigious Order of the Coif. After graduation, Judge Breithaupt joined the Miller Nash law firm as an associate. In 1978 he joined the predecessor firm to Stoel Rives, becoming a partner in 1981. His practice focused on federal income taxation, state tax, and business matters.

While in private practice, Judge Breithaupt provided pro bono legal services to many groups, including the American Tinnitus Association, American Spina Bifida Association, New Song Russian Christian School of Music, Tongan Community Services, Portland Computer Training Institute, Center for the Study of Religion at PSU, and the Portland Baroque Orchestra. He also previously served as a board member for the OSB Taxation Section, DePaul Treatment Centers, and Lutheran Family Services. He has also been a reporter for Oregon Tax Matters, Committee on State Taxation, and Oregon ABA Bank and Thrift Institution Tax Bulletin.

In 2001, governor John Kitzhaber appointed Judge Breithaupt to the Oregon Tax Court. Judge Breithaupt was subsequently elected in 2002 and reelected in 2008 for six year terms. In addition to hearing tax cases, he also serves weekly as pro tem judge in Multnomah County or Clackamas County, and he has served pro tem on the Oregon Court of Appeals. He was awarded the Lawrence L. Lasser Tax Judge of the Year Award in September 2012 at the 32nd Annual National Conference of State Tax Judges.

Judge Breithaupt has been an Adjunct Professor of Law at Lewis & Clark Law School, teaching the National Tax Moot Court Program; and Willamette University College of Law, teaching courses in federal income taxation and state and local taxation. He previously served as a member of the executive committee of the OSB section on Constitutional Law and as a member of the State Lawyer Assistance Committee. Currently, he coaches the Grant High School Constitution Team, which won the national award this year.

Judge Breithaupt has been married for 36 years and has three adult children. He is an avid reader and traveler, with a current focus on meeting his wife's recently discovered relatives in Serbia and Croatia. He also cares for and exercises his family's dogs, Milo and Edmond.

About the Court

The Oregon Tax Court was created in 1961 by the Legislative Assembly to provide uniform application of tax laws statewide. It is a specialized court that hears only state and certain local tax cases, including personal income tax, property tax, corporate excise tax, timber tax, local budget law, and property tax limitations. The Tax Court has one Judge in the Regular Division, and three magistrates in the Magistrate Division. Most appeals to the Tax Court are first filed in and heard by the Magistrate Division. The decision of the Magistrate can be appealed to the Regular Division. Appeals from the Regular Division go directly to the Oregon Supreme Court.

Judge Breithaupt emphasized the important role of the Magistrate Division, including its ability to complete work in a timely manner and handle most of the disputes. The staff of the court, Breithaupt said, is "widely recognized as attentive and responsible to the public."

For more on the Tax Court, ***see*** Henry C. Breithaupt & Jill A. Tanner, ***The Oregon Tax Court at Mid-Century***, 48 Willamette L. Rev. 147 (2011).

About the Award

The OSB Taxation Section Award of Merit is granted to a nominee who exemplifies standards of professionalism. It recognizes and honors personal and professional qualities, reputation, conduct, and leadership activities and service within the bar or the community, including pro bono service. Recipients should be role models for other attorneys, especially younger attorneys. Any active OSB member in good standing is eligible to receive the Award.

Credits Against the Oregon Corporate Minimum Tax Under Con-way, Inc. & Affiliates v. Department of Revenue – Oregon Supreme Court Update

By Thomas M. Karnes[1]

In May 2013, the Oregon Supreme Court published its opinion for ***Con-way, Inc. & Affiliates v. Department of Revenue***, which was an appeal from the Oregon Tax Court's 2011 decision.[2] This article updates, "Credits Against the Oregon Corporate Minimum Tax Under ***Con-way, Inc. & Affiliates v. Department of Revenue***," published in the Winter 2013 edition of the OSB Tax Section newsletter.

The dispute between Con-way, Inc. ("Con-way") and the Oregon Department of Revenue ("ODOR" or the "Department") stemmed from whether a taxpayer may use an Oregon Business Energy Tax Credit ("BETC") to offset amounts owed under Oregon's corporate excise minimum tax as set forth in Oregon Revised Statute ("ORS") 317.090. In February 2008, the Oregon Department of Energy issued Con-way a final certificate for a $75,000 BETC that Con-way acquired through the pass-through partner program.

For Con-way's 2009 tax year, the company reported a $75,000 corporate minimum tax liability pursuant to ORS 317.090. Con-way applied its BETC against its $75,000 reported Oregon tax liability in its 2009 corporate excise

1 Thomas M. Karnes is an attorney at the law firm of Ater Wynne LLP.

2 *Con-Way, Inc. & Affiliates v. Department of Revenue*, 353 Or. 616 (2013); *Con-Way, Inc. & Affiliates v. Department of Revenue*, TC 5003 (December 27, 2011).

tax return. The ODOR disallowed Con-way's application of the BETC and assessed Con-way for a deficiency of $25,000, as well as related penalties and interest, in a Notice of Assessment for the 2009 tax year.

Con-way appealed the Notice of Assessment to the Magistrate Division of the Oregon Tax Court in February 2011. In April 2011, Judge Breithaupt of the Oregon Tax Court designated the case for a hearing with the Regular Division of the Tax Court. Between July and August of 2011, both Con-way and the ODOR filed motions for summary judgment.[3]

Both Con-way and the ODOR, along with the Oregon Tax Court and Oregon Supreme Court in their respective opinions, approached the dispute as one of statutory interpretation and construction, focusing largely on how the Oregon legislature intended for taxpayers to satisfy amounts owed under the Oregon corporate minimum tax. Con-way's principal argument was that under a plain reading of ORS 315.354(1), which allows a "credit … against the taxes otherwise due under ORS chapter 316 (or, if the taxpayer is a corporation, under ORS chapter 317 or 318) …[,]" a corporate taxpayer will be allowed to use the BETC as a credit "against the taxes otherwise due" under ORS chapter 317.[4] The ODOR, by contrast argued that the Oregon corporate excise minimum tax under ORS 317.090 is "just that—a 'minimum' that each corporate excise taxpayer must 'pay'".[5] In the ODOR's view, allowing the BETC to reduce the minimum excise tax would render "ORS 317.090 of no effect, since the 'minimum' tax under ORS 317.090 would be greater than the least amount that is 'payable in full' if the BETC is allowed as a credit against the amount under ORS 317.090."[6]

The Oregon Tax Court granted Con-way's motion for summary judgment, concluding that the ODOR's argument, in effect, asked: "the court to add words to the statute so that it reads that there is an obligation to pay 'in cash and without regard to any tax credit otherwise available to the taxpayer."[7] The Tax Court continued, noting:

> Not only does the statute not contain those words, the context of the revenue laws as a whole indicates that when the legislature desires to prevent a tax credit from being used to satisfy a minimum tax obligation, it knows how to say so and has, in fact, said so.[8]

The ODOR appealed the Tax Court's decision to the Oregon Supreme Court in February 2012.[9] Pending the release of the Supreme Court's decision, the ODOR maintained the position that, "taxpayers cannot use tax credits to reduce the corporate minimum tax" and deferred action on any refund claims.[10]

The Oregon Supreme Court heard oral arguments for the case in March 2013 and published Justice Brewer's opinion two months later. The Supreme Court framed the arguments from Con-way and the ODOR as concerning "the meanings of the terms 'pay' and 'minimum' in ORS 317.090(2), and the term 'credit' in ORS 315.354(1)."[11] In particular, the Oregon Supreme Court described the ODOR's position as the following:

> a BETC may not be used to satisfy the minimum tax payable under ORS 317.090(2), because (1) tax 'credits' can operate only to reduce, not fully satisfy, a tax liability; (2) a 'minimum' tax cannot be reduced; and (3) a credit may not be used to 'pay' a tax because the term 'pay' requires cash payment.[12]

The ODOR supported that position arguing that that the term "minimum" in ORS 317.090(2) bars the use of credits to satisfy a corporation's minimum tax liability and that a tax credit cannot be used to pay the minimum tax because tax credits operate only to "reduce" tax liability, not pay it.[13] The Oregon Supreme Court addressed both arguments.

As to whether ORS 317.090(2) bars the use of credits to satisfy a corporation's minimum tax liability, the Oregon Supreme Court concluded that, based on the statutory context, the legislature intended for the term "minimum" to relate to the amount of the tax imposed, not on how it must be satisfied.[14] The legislature has added language in other statutes specifying that certain credits, such as contributions for certain technical property and the surplus kicker credit, are expressly not eligible for reducing a corporation's minimum tax.[15] Paraphrasing an argument from Con-way, the legislature's express limitations on using certain credits to reduce the corporate minimum tax "demonstrates that, when the legislature intends not to allow a tax credit against the minimum tax …, it does so explicitly."[16] Justice Brewer's opinion cites additional background on the legislature's enactment of the corporate minimum tax in ORS 317.090(2), including a history of prohibiting and allowing credits as a discount for the minimum tax, as evidence that the legislature's omission

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3 *Con-Way, Inc. & Affiliates v. Department of Revenue*, *supra*, Stipulation of Facts (June 6, 2011).

4 Pl.'s Mot. for Summ. J. and Resp. to Mot. to Dismiss 4 (July 5, 2011).

5 Def.'s Cross-Mot. for Summ. J. 1 (August 2, 2011).

6 *Id*., at 3.

7 *Con-way, Inc. & Affiliates v. Department of Revenue*, TC 5003 (December 27, 2011).

8 *Id*.

9 Oregon Supreme Court S060141 (February 16, 2012).

10 Oregon Department of Revenue, Corporate Taxes, available at: http://www.oregon.gov/DOR/BUS/Pages/corp-tax_main.aspx. (November 2012).

11 *Con-Way, Inc. & Affiliates v. Department of Revenue*, 353 Or. 616, 620 (2013).

12 *Id*. at 620.

13 *Id*. at 621-24.

14 *Id*. at 624.

15 *Id*. (noting ORS 317.151(5)(a) (technical property), ORS 291.349(3) (kicker)).

16 *Id*. at 625.

of an express limitation on using the BETC to satisfy the corporate minimum tax was purposeful.[17]

The ODOR provided multiple arguments as to why the term "minimum" bars a taxpayer from using a BETC to reduce amounts owed under the corporate minimum tax, including whether allowing a BETC to offset the corporate minimum tax is contrary to the intent of votes in enacting Measure 67 (2010), which amended ORS 317.090 to raise the corporate minimum tax from $10 to the variable scale resulting in a $75,000 minimum tax obligation for Con-way in this case. The Supreme Court was unconvinced or otherwise disagreed, noting that those arguments fell short of establishing that the legislature intended to prohibit taxpayers from reducing their minimum tax liability through a BETC notwithstanding the legislature's practice of identifying those limitations explicitly.[18]

For whether a tax credit can be used to pay the minimum tax because tax credits operate only to "reduce" tax liability, not pay it, the ODOR pointed to multiple statutes in which the legislature used the term "pay" and "payments" separately from the term "credits."[19] The ODOR supplemented that position with an argument that the word "pay" and "tax" in ORS 317.090(2) required payment in cash.[20] Justice Brewer acknowledged that the legislature has used those terms to represent distinct concepts in some scenarios, but notwithstanding those distinctions, both payments and credits reduce the amount of tax owed.[21] Accordingly, in the Supreme Court's view, that context "reinforces the conclusion that the BETC provides a method of satisfying taxes otherwise due under ORS 317.090(2)."[22] Likewise, Justice Brewer's opinion notes that the meaning of the phrase "tax" shows that, "although monetary in nature, a tax need not be paid in cash."[23] In other words, the legislature did not intend by its use of the term "tax" in ORS 317.090(2) "to require that the minimum tax imposed by that statute be paid in cash."[24]

Following publication of the Oregon Supreme Court's decision in *Con-way*, the ODOR has stated on its website that "although the *Con-Way* decision addressed only the BETC, the Department is interpreting the ruling "to broadly apply to corporation tax credits."[25] The ODOR further noted that, in light of the *Con-way* ruling, only two credits are specifically prohibited from being allowed against the corporate minimum tax: contributions of computers or scientific equipment credit[26] and the surplus kicker credit.[27] The ODOR website also notes that the Department's tax return processing system does not currently allow for the reduction of the minimum tax with credits. The ODOR states that it is in the process of updating its processing system and expects to begin processing returns and issuing refunds on October 1, 2013.

For taxpayers that filed a timely protective refund claim on an amended tax return, the ODOR states that there is no need to contact the Department and that the return will be processed as soon as the ODOR's processing system has been updated. For protective refund claims filed in a letter format, the ODOR requests that taxpayers file an amended tax return, which the ODOR will then process as soon as its processing system has been updated.[28] Taxpayers who did not file a protective refund claim may still submit an amended corporate tax return to the extent the refund statute of limitations window remains open.[29]

17 *Id*. ("We presume that that omission was purposeful. Although the legislature may not have foreseen that a taxpayer would seek to apply a BETC to the corporate minimum tax ... the text of [the BETC statute] nevertheless does not prohibit application of the BETC to the minimum tax.").

18 *Id*. at 625-29.

19 *Id*. (citing to ORS 314.4009(9) (penalties for failing to file returns or pay tax when due), ORS 315.068(5) (repayment adjustments), and ORS 305.265(12) (tax deficiencies)).

20 *Id*. at 630.

21 *Id*. at 623 (ORS 314.4009(9) (penalties for failing to file returns or pay tax when due), ORS 315.068(5) (repayment adjustments), and ORS 305.265(12) (tax deficiencies).

22 *Id*.

23 *Id*. at 631.

24 *Id*.

25 Oregon Department of Revenue, Corporate Taxes, available at: http://www.oregon.gov/DOR/BUS/Pages/corp-tax_main.aspx. (last visited August 25, 2013).

26 ORS 317.151.

27 ORS 291.349.

28 If the refund statute of limitations has expired for a taxpayer's amended return, the ODOR requests that taxpayers attached a statement to the return indicating that the taxpayer filed a timely protected refund claim in letter format.

29 Oregon Department of Revenue, Corporate Taxes, available at: http://www.oregon.gov/DOR/BUS/Pages/corp-tax_main.aspx. (last visited August 25, 2013).

Taxation Section Mentor Program End of Year Celebration

Congratulations to Jeffrey S. Tarr — Our 2013 Mentor of the Year

Jeffrey S. Tarr was selected as the recipient of the 2013 Mentor of the Year Award given by the New Tax Lawyer Committee of the Taxation Section. Tarr stands out as a mentor because he is an excellent teacher. He has generously given time and energy to improve the Taxation Section, not only as a mentor, but also as a member of the Executive Committee and as an editor of the newsletter. He is known for giving practical advice that includes important lessons about the business aspects of a law practice, the culture of the legal community, and substantive tax issues, including ethics and standards of practice. Tarr is the Chair-Elect of the Taxation Section, and he is a Partner at Sussman Shank LLP in Portland where his practice concentrates on complex business, real estate, and tax matters.

The award will be given at the Taxation Section Mentor Program End of Year Event on Wednesday, November

13 at 5:30 p.m. at the Lotus Cafe, 932 SW 3rd Avenue, Portland, Oregon. Additional information about the Award, including criteria and a list of past recipients is available online at http://osbartax.com/Mentor-of-the-Year-Award

If you are interested in participating in the 2014 Taxation Section Mentor Program, please complete the Mentor Program Questionnaire and email your responses to NTLCMentorProgram@gmail.com on or before December 6, 2013. Forms are available on the Taxation Section website at http://osbartax.com/mentor-program.

IRS and DOL Adopt "Place of Celebration" Marriage Rule for Retirement Plans

By Denise Coderre[1]

As you probably know, the June 26, 2013, *U.S. v. Windsor* Supreme Court decision struck down section 3 of the Defense of Marriage Act of 1996 as unconstitutional.[2] Section 3 limited federal recognition of marriage to "one man – one woman" regardless of state law. Section 2 of DOMA, which the Supreme Court did not address, continues to allow states to refuse recognition of same-sex marriages performed in other jurisdictions. Thus, guidance was needed concerning when to recognize a marriage given that same-sex marriage is not recognized by all states. The Supreme Court held the federal government must defer to state law to determine marital status; however, it did not answer the basic question, "Which state law?" On Aug. 29, 2013, IRS Rev. Rul. 2013-17 settled this question for us: any state law. DOL mirrored this guidance in Technical Release 2013-04 issued on Sept. 18, 2013. This article summarizes the impact of *Windsor* on retirement plans and the significance of the IRS and DOL guidance.

Conflicts in State Law

Prior to *Windsor*, most retirement plans were not concerned in state law marriage differences because DOMA provided federal law consistency. Post-*Windsor* and prior to federal guidance, state law very much mattered. For example, if a participant living and working in Oregon (a state that does not recognize same-sex marriage) was married in New York (a state that performs and recognizes same-sex marriages), basic plan administration questions were not necessarily clear-cut. Without guidance, this choice of law dilemma whether to base marital status on Oregon law (i.e., marriage not valid) or New York law (i.e., marriage valid) created questions such as:

- Must spousal consent be obtained?
- Who is the default beneficiary?
- Is a spousal rollover allowed upon participant death?
- If a same-sex spouse beneficiary elects a lump sum, do the mandatory withholding requirements of an eligible rollover distribution apply?
- How does the marriage affect family attribution rules for determining controlled groups and highly compensated employees?
- Do the answers change if a participant moves to a state that treats same-sex marriage differently?

Individuals and plan administrators speculated how to determine marital status. Existing cases were argued in lower courts. For roughly two months following the *Windsor* decision, the IRS website had a brief statement that simply said: *"We are reviewing the important June 26 Supreme Court decision on the Defense of Marriage Act. We will be working with the Department of Treasury and Department of Justice, and we will move swiftly to provide revised guidance in the near future."*

Place of Celebration Concept

As further background to state laws, ordinarily, states follow a "place of celebration" rule to recognize a marriage created under any other jurisdiction as long as it is not against public policy. This means states recognize a marriage from another state or foreign country even if that marriage would not have been allowed in the domiciliary state (e.g. due to age, consanguinity, or in some cases common-law marriage). Hence, if first-cousins married in one state, they could move across state lines without fear their new home state would not recognize their marriage – despite the fact they could not have legally married in their new home state due to consanguinity prohibitions.

In a departure from the typical place of celebration rule, many states began adopting statutes specifically refusing recognition of same-sex marriages. At the same time, although prohibiting same-sex marriage, some states adopted civil union or domestic partnership statutes that purported to give partners the same state rights and responsibilities as those of a spouse. Thus a regime was created in which someone could be a spouse for one purpose, or in one locale, but perhaps not for another purpose or in another locale. This abandonment of the place of celebration rule could lead to confusion at a state level; however, DOMA tempered this confusion at a federal level. As Justice Scalia points out in his *Windsor* dissent, "DOMA avoided all of this uncertainty by specifying which marriages would be recognized for federal purposes."[3] After DOMA sec. 3 was held unconstitutional by the majority, questions arose concerning how to resolve conflicts of state law for federal tax and employee benefits.

IRS and DOL guidance

Fortunately, the IRS post-DOMA guidance issued on Aug. 29, 2013 easily cleared up much of the uncertainty. Rev. Rul. 2013-17 states in part:

1 Denise L. Coderre is an in-house attorney at Standard Retirement Services Inc.

2 *U.S. v. Windsor*, 570 U.S. ____ (2013).

3 *Windsor* at 30.

> "…individuals of the same sex will be considered to be lawfully married under the Code as long as they were married in a state whose laws authorize the marriage of two individuals of the same sex, even if they are domiciled in a state that does not recognize the validity of same-sex marriages. For over half a century, for Federal income tax purposes, the Service has recognized marriages based on the laws of the state in which they were entered into, without regard to subsequent changes in domicile, to achieve uniformity, stability, and efficiency in the application and administration of the Code. Given our increasingly mobile society, it is important to have a uniform rule of recognition that can be applied with certainty by the Service and taxpayers alike for all Federal tax purposes. Those overriding tax administration policy goals generally apply with equal force in the context of same-sex marriages."

In this ruling, the term "state" means any domestic or foreign jurisdiction having the legal authority to sanction marriages. Therefore, in the earlier example of an Oregon same-sex couple married in New York, the couple's marriage would be valid for all federal tax purposes regardless of where they lived or worked. Likewise, the marriage would be federally recognized had it occurred in a foreign country such as Canada. For retirement plan purposes, this means a plan's definition of spouse necessarily includes spouses in a same-sex marriage valid under any state, territory or foreign country. This conclusion is presumably the same regardless of whether the plan is ERISA or non-ERISA if it is established under the Internal Revenue Code (e.g., 457, 403(b), or 401(a)). Hopefully future guidance will clarify any non-ERISA exceptions, particularly for church plans. The ruling does make clear that absent a state-sanctioned marriage, individuals in civil unions or domestic partnerships are not spouses for federal tax purposes.

DOL Employee Benefits Security Administration, which generally interprets and enforces title I of ERISA, also issued guidance in complete agreement with the IRS ruling. Technical Release 2013-04, dated Sept. 18, 2013, states this interpretation of "marriage" and "spouse" is the "most natural reading of those terms," and provides a uniform rule of recognition that can be applied with certainty. The core intent underlying ERISA to promote uniform requirements for employee benefit plans provides further justification, and a narrower interpretation would not further the purposes of the relevant statutes and regulations.

Effective date and retroactivity

The terms of Rev. Rul. 2013-14 were effective Sept. 16, 2013. Spouses must file federal tax returns as married persons on or after this date, i.e., all 2013 returns. Taxpayers who wish to rely on the guidance for earlier periods may do so to request tax refunds within the statute of limitations, generally three years from the original tax filing date or two years from the date the tax is paid.[4] A refund can be claimed if employer-provided health coverage for a same-sex spouse was taxed or if premiums were paid by the employee on an after-tax basis because of denial of pre-tax cafeteria plan treatment that was available to opposite-sex spouses.[5]

The IRS intends to issue guidance on the retroactive application of other employee benefits, including retirement plans.[6] Such guidance will take into account the potential consequences of retroactive application to all taxpayers involved, including the plan sponsor, the plan or arrangement, employers, affected employees and beneficiaries. The IRS anticipates the future guidance will provide sufficient time for plan amendments and any necessary corrections so that the plan and benefits will retain favorable tax treatment for which they otherwise qualify.

The DOL did not specify an effective date or address retroactivity. At a minimum, the guidance should be applied immediately. Like the IRS, the DOL intends to issue future guidance addressing specific provisions and regulations.[7] The DOL has thus far coordinated with Treasury/IRS in developing its guidance, and common sense would dictate them to continue this approach where there is overlap.

Conclusion

The collective sigh of relief from the retirement plan community was nearly audible nationwide upon learning the IRS had issued amazingly straight-forward, no-nonsense guidance. Does the guidance answer every question? No. What happens if a same-sex spouse was denied a qualified pre-retirement survivor benefit last year? What if someone was married in New Mexico or Pennsylvania where county clerks proactively issued marriage licenses in August despite legal challenges? What if beneficiaries make competing claims for death benefits when a participant assumed spousal consent was unnecessary under DOMA? We can pose theoretical questions, but hopefully current guidance answers our most immediate, real-life questions such as, "Do I need to get spousal consent to designate my children as my beneficiary?" Yes! Whatever questions do still remain, they pale in comparison to the challenges plan administrators and participants would have faced had marital status depended on where an individual lived or worked. In the meantime, as we eagerly await the additional promised guidance, the announcement to use the "place of celebration" rule is indeed cause for celebration!

Hyperlinks:

- *Windsor* opinion: http://www.supremecourt.gov/opinions/12pdf/12-307_6j37.pdf

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4 IRC § 6511.

5 Rev. Rul. 2013-17 at 14.

6 Id.; IRS FAQ for Same Sex Married Couples, Q&A 19.

7 DOL Technical Release 2013-04 at 3.

- IRS Announcement: http://www.irs.gov/uac/Newsroom/Treasury-and-IRS-Announce-That-All-Legal-Same-Sex-Marriages-Will-Be-Recognized-For-Federal-Tax-Purposes;-Ruling-Provides-Certainty,-Benefits-and-Protections-Under-Federal-Tax-Law-for-Same-Sex-Married-Couples
- Rev. Rul. 2013-17: http://www.irs.gov/pub/irs-drop/rr-13-17.pdf
- IRS FAQ for Same Sex Married Couples: http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples
- IRS FAQ for Domestic Partners/Civil Unions: http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions
- DOL Technical Release 2013-04: http://www.dol.gov/ebsa/pdf/tr13-04.pdf

Taxation in Popular Culture: *Pursuit of Happyness*[1]

By Dan Eller[2]

Movies, television shows, and music offer sometimes enjoyable breaks from our busy lives. Even during this downtime, however, we occasionally see how our lives and those of our clients are portrayed by Hollywood and the music industry – sometimes accurately, sometimes… not so much. I find these portrayals interesting because they can remind us about important aspects of our practices. And, sometimes, they show us how misunderstood tax law can be. *Taxation in Popular Culture* is intended to be a series in which we explore these portrayals.[3] In that regard, this series is part diversion/part introspection.

In director Gabriele Muccino's *Pursuit of Happyness*, we see the film adaption of the biography of Chris Gardner. Without ruining the entire plot, the movie presents the story of Mr. Gardner's transition from briefly homeless single father to stockbroker and entrepreneur. Will Smith portrays Mr. Gardner and Mr. Smith's son, Jaden, plays the part of Christopher Gardner, Jr.

The scene that drew my attention to this movie occurs at about the midway point during the story. In this scene, first we see Will and Jaden Smith smiling and enjoying each other's company as they commute back to their temporary residence at an area hotel. They are about as happy in this scene as they are at any point during the movie. Immediately following this happy moment, however, we see Mr. Smith coming out of the main office of his apartment building carrying a notice from the Internal Revenue Service: essentially all of his remaining savings have been seized by the IRS. The camera pans over the envelope, on which is seen a mail-forwarding sticker of the type the United States Postal Service normally affixes to a forwarded item of mail.[4] The scene ends with Mr. Smith arguing with someone, apparently an IRS employee, to no avail; the IRS will not be returning any portion of the seized funds.

In terms of accuracy, this scene does a very good job of showing what it is like to be in Mr. Smith's situation. Mr. Smith's frustration and anger is palpable, and seeing the fear in his son's eyes as Jaden watches his father plead with the IRS (or the bank, as the case may be) is real. We sympathize with Mr. Smith and worry about his future and that of his son. From the perspective of a tax-controversy attorney, this scene reminds us that many of our clients come to us after experiences just like the one described above – they may be scared, angry, and/or confused. It is important to recognize how deeply emotional tax controversies can be. If for no other reason, *Pursuit of Happyness* presents a powerful cultural portrayal of issues that are presented to many tax attorneys. Beyond the emotional, the movie sets up discussions of several important issues that can arise in tax-controversy representations.

Last-known-address rule. We see the U.S. Post Office attempted to forward the IRS correspondence to Mr. Smith, who, by this point in the story, had lived in a number of different places. Although we cannot know whether Mr. Smith fastidiously updated the IRS with his new address each time he moved, we do know the IRS is permitted to send correspondence to the last address for the taxpayer known to the IRS.[5] You should not take the fact that the IRS sent its notice to the correct address as a given, however, because the IRS's failure to send its correspondence to your client's last-known address can be used as a shield to IRS collection actions.

Collection Due Process ("CDP"). Perhaps the most distressing aspect of this scene is the fact that the IRS seized Mr. Smith's last dollars, money on which he needed to pay his rent and other living expenses. In order to seize a taxpayer's property, the IRS is required to send to the taxpayer several notices.[6] Most notably, the IRS must issue

1 Pursuit of Happyness (Columbia Pictures Corporation, et al. 2006).

2 Dan Eller is a shareholder in the Portland, OR office of Schwabe, Williamson & Wyatt, who focuses his practice in the areas of tax and business law, advising clients with both transactional and controversy matters. Dan is currently Secretary of the Oregon State Bar Taxation Section.

3 I have an inventory of these I plan to work through in future newsletters, if you find it to be interesting and of value. If you know of a particular scene, movie, show, or lyric you think would fit the mold of this series, please email me at deller@schwabe.com.

4 I did not attempt to determine whether the U.S. Post Office used this type of label at the time depicted in this scene. Moreover, for purposes of this article, I assume the notice depicted in the movie is similar to the type currently issued.

5 *See* Treas. Reg. § 301.6212-2.

6 *See* 26 U.S.C. §§ 6212, 6213. As noted above, this article assumes the events of this movie occur today, not in the 1980s.

a Final Notice of Intent to Levy to the taxpayer.[7] Such a Notice provides the taxpayer 30 days in which to appeal from the proposed collection action. That appeal must be based on due process grounds, such as the availability of a collection alternative. The CDP Appeal form[8] presents two common collection alternatives: offer in compromise and installment agreement. Additionally, a taxpayer might seek the protections of bankruptcy (in which case a CDP appeal might be unnecessary) or request to be placed in currently not collectible ("CNC") status. Here, Mr. Smith appears to be a good candidate for CNC status, but he did not timely appeal the IRS proposed collection actions. That is not uncommon. In such cases, you might consider an equivalent hearing (which does not provide Tax Court review, as does CDP). In any event, it appears as though either Mr. Smith had not received or had not responded to prior IRS correspondence in time to avail himself of any collection alternative. Finally, it should be noted that in hardship cases, sometimes a simple phone call to the IRS can result in the refund of levied funds and the discontinuation of enforced collection activities, even when the taxpayer has missed important deadlines, such as the CDP appeal deadline.

Clients in Extremes. Tax controversy representations can present tax attorneys with some of the most challenging and rewarding issues of their careers. We are often plowing new legal grounds and exploring the edges of constitutional taxation and collection. The clients who present these opportunities, however, often cannot pay for our services. For many of us, this means we may need to dip into our reserve of pro bono hours; for others, it is important we know that in Oregon we have several qualified low-income clinics to which we can refer clients of this type: Legal Aid Services of Oregon, Catholic Charities, and the Lewis & Clark Low-Income Taxpayer Clinic. Should you take on the client for a fee, you should consider whether an advanced-fee deposit or retainer is appropriate. If so, you should look to obtain most, if not all, of your anticipated fee in advance. In any event, you should be mindful that these clients are often under incredible stress, both financial and emotional.

In conclusion, I score this scene in ***Pursuit of Happyness*** Six out of Eight Volumes of Regs. My rating is based primarily on the emotional highs and lows portrayed by the actors. If you take nothing else from this movie, you should be reminded that our clients are not emotionless people unencumbered by stress. I reduced my score because, although the issues this scene sets up are real, we are left without a clear explanation as to how Mr. Smith wound up where he did. Additionally, some of the statements Mr. Smith makes are not accurate in light of today's applicable laws and regulations. I might have given a higher score if the movie further explored Mr. Smith's battle with the IRS and the reasons for the ultimate seizure of his bank funds. But, then again, that probably would have driven audiences from theaters.

7 In his voiceover, Mr. Smith states, "If you didn't pay 'em, the government could stick their hands into your bank account and take your money. No warning. Nothing." That statement is not an accurate characterization of the applicable law in the present time, but is likely honestly how Mr. Smith felt if the notice we see him opening is the first one he actually received due to his frequent moves.

8 Treasury Form 12153, available at http://www.irs.gov/pub/irs-pdf/f12153.pdf.