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US Multistate Tax Alert

Oregon Tax Court decision regarding apportionment and income classification

Overview

Oregon Tax Court holds for Taxpayer on some apportionment and income classification issues

In a consolidated order[1] regarding issues for summary judgment following the related 2018 Oregon Supreme Court decision in *Comcast Corp. v. Dept. of Rev.*;[2] the Oregon Tax Court ("Tax Court") ruled in favor of Comcast ("Taxpayer") regarding the use of Oregon's special industry "audience ratio" apportionment for interstate broadcasters. The order also addresses nonbusiness income classification of certain dividends and gains from stock holdings, which has potential application for Oregon taxpayers beyond interstate broadcasters as specified in the order.

This Tax Alert summarizes the Tax Court's order specifically focusing on the apportionment of receipts of an interstate broadcaster and the classification of nonbusiness income.

Procedural history

This Tax Court decision concerns numerous issues for summary judgment before the Court. This case consolidates appeals covering two separate Oregon corporate excise tax audits.[3] The first appeal covers the audit cycle of tax years 2007-2009 (the "2007-09 Appeal"), the second appeal covers the audit cycle for tax years 2010-2012 (the "2010-2012 Appeal"). In the 2007-2009 Appeal, the Taxpayer and the Oregon Department of Revenue's ("Department") disagreed over how Taxpayer should calculate its audience ratio as required by Oregon's interstate broadcaster apportionment regime and the 2018 Oregon Supreme Court's interlocutory decision in *Comcast Corp. v. Dept. of Rev.*[4] The Oregon Supreme Court heard the case but issued a limited judgment ("Limited Judgment") only on the issue of whether the taxpayer could apportion its taxable income as an interstate broadcaster. The Oregon Supreme Court found that

> except for receipts from sales of real or tangible personal property, all gross receipts from transactions and activities in the regular course of Taxpayer's trade or business--not solely

> receipts from "broadcasting" activities--constitute "gross receipts from broadcasting" and are included in the numerator of Taxpayer's sales factor in the ratio that Taxpayer's Oregon audience bears to its total audience.[5]

The Taxpayer also protested the Department's determination of that certain dividends and gains were business income.

While the 2007-2009 Appeal progressed, the Department concluded its audit for the 2010-2012 tax years and made similar adjustments disallowing the apportionment of income as an interstate broadcaster and reclassifying of certain items of income from nonbusiness to business income. The parties held the 2010-2012 Appeal in abeyance awaiting the outcome of the 2007-2009 interlocutory Appeal on the broadcaster apportionment issue.

Once the Limited Judgment was published, the Taxpayer and Department continued proceedings upon the remaining issues in the 2010-2012 Appeal. As both matters concerned fundamentally the same issues, the two Appeals were consolidated for the hearing on numerous motions of summary judgment before the Tax Court.

In this consolidated case, the Tax Court granted Taxpayer's motion for summary judgment regarding its method of calculating the "audience ratio" apportionment for interstate broadcasters and granted two of three of the Taxpayer's motions for summary judgment on its nonbusiness income classification of dividends received and gains from the sale of ownership interests.

Audience/Subscriber ratio for interstate broadcaster apportionment

In the Limited Judgment, the Supreme Court determined that Taxpayer met Oregon's statutory definition of an interstate broadcaster[6] and that Oregon's definition of "gross receipts from broadcasting" means all receipts from transactions and activities in the regular course of the taxpayer's trade or business other than sales of tangible personal property or real property – not merely receipts from broadcasting activity as the Taxpayer had argued.[7] The first issue before the Tax Court in the present case was how Taxpayer should determine its audience or subscriber ratio to apportion its gross receipts from broadcasting.[8]

Taxpayer had two varieties of broadcasting audience, 1) television network operations, and 2) cable television subscription services, which audiences needed to be reconciled into a single "audience ratio". Taxpayer applied a methodology that focused on preventing double-counting its customers. Taxpayer used Nielsen data to determine its audience for its television network operations. For its cable television subscription services, Taxpayer only included unique subscribers by removing duplicated person who either subscribed to multiple Taxpayer's networks or were already included within the Nielsen data. The sum of the unique Oregon audience members and subscribers constituted Taxpayer's Oregon numerator and the sum of the unique audience members and subscribers across the nation constituted its denominator. Under Oregon's interstate broadcaster apportionment regime, Taxpayer applied this ratio (the "Broadcaster Ratio") to its "gross receipts from broadcasting."[9]

The Department disagreed with this approach, arguing that because Taxpayer was "primarily" a cable subscription company, Taxpayer should calculate its Broadcaster Ratio numerator using only the number of subscribers and excluding its audience members.[10] Based on a thorough analysis of the statutory language and the corresponding legislative history analysis, the Tax

Court found no support for the Department's argument that Taxpayer must only use its subscribers and exclude its audience members from its Broadcaster Ratio numerator.[11] Further, the Tax Court noted that calculating the Broadcaster Ratio numerator exclusive of one population or the other would be inconsistent with the determination of the Broadcast Ratio's denominator because the statute explicitly requires the inclusion of both total audience and subscriber populations.[12]

Nonbusiness income classification

The second issue in the Tax Court's order focuses on the Taxpayer's classification of certain income items as nonbusiness income. As part of some significant business acquisitions, Taxpayer acquired minority ownership interests in two corporations and one LLC.[13] Shortly after acquisition, Taxpayer sold these interests, although Taxpayer received some dividends from these corporations prior to the divestiture.[14] Taxpayer classified these dividends as well as the gains on the sale of ownership interest as nonbusiness income.[15] Taxpayer did so on the basis that none of the three companies at issue were unitary with the Taxpayer and that none of its direct or indirect ownership of these entities served "an operational function in taxpayer's business."[16]

While the Department agreed that the companies were not unitary with Taxpayer, it disagreed that the Taxpayer's holdings did not serve an operational function under *Allied-Signal* because Taxpayer's "mergers and acquisitions activity…was a part of [Taxpayer's] regular course of business."[17] Applying the U.S. Supreme Court's decision in *Allied-Signal*[18] and Oregon case law interpreting *Allied-Signal*, the Tax Court analyzed each "asset's use and its relation to the taxpayer and its activities within the taxing State" to Taxpayer and its ownership interests. [19] The Tax Court found that the gain from the sale and dividends received from the two corporations were non-apportionable because the corresponding "stock did not serve an operational function" for the Taxpayer. [20] The Tax Court listed a number of reasons that the minority interests in the companies were not part of Taxpayer's operational function, including:

- These minority interests were acquired as a consequence of larger acquisitions,[21]
- The Taxpayer had a regulatory requirement to divest of the stock upon completion of the larger acquisition,[22] and
- There was no indication that these ownership interests were either utilized as working capital[23] or served to hedge changes in Taxpayer's operating costs.[24]

As such, the Tax Court granted Taxpayer's motion for summary judgment on this issue as it applies to its ownership in the two corporations.

Regarding the gain from the sale of the ownership interest in the LLC, which was a pass-through entity for income tax purposes, the Tax Court did not rule for either the Taxpayer or the Department, instead inviting further briefing and motions. The Tax Court was "inclined to conclude that Taxpayer's gain on the sale of its interests in [the LLC] is not subject to apportionment[25] But the Court refrained from ruling as it noted that the parties did not brief certain issues the Tax Court found germane (e.g., is the sale of a partnership interest akin to the sale of stock or should the court look through the partnership to its underlying assets).

The Department also raised two additional arguments that the income at issue was apportionable: the income meets the UDITPA definition of business income under ORS 314.610(1) and these income items are apportionable because the definition of an interstate broadcaster definition is broader than business income. The Tax Court quickly addressed and rejected these arguments. The Court found that the UDITPA definition of business income was not absolute and is constrained by Constitutional limitations.[26] Additionally, the Tax Court determined that Oregon's definition of "gross receipts from broadcasting" cannot expand the applicable definition of "business income".[27]

The Tax Court's order analyzed numerous other issues that are outside the scope of this Tax Alert.

Considerations

This Tax Court order largely focuses on a taxpayer subject to the interstate broadcaster apportionment regime; however, the portions of the order that focus on the question of business versus nonbusiness income may apply to taxpayers that are not subject to that special industry sourcing rule. Accordingly, this order may provide helpful guidance for any Oregon taxpayer analyzing this complex and fact-specific question and should be carefully considered.

Contacts

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[1] *Comcast Corp. v. Dep't of Revenue*, Nos. TC 5265, TC 5346, 2020 Ore. Tax LEXIS 63 (T.C. Nov. 25, 2020).
[2] *Comcast Corporation and Subsidiaries v. Department of Revenue*, 363 Or. 537 (August 16, 2018). This case is discussed in a previously issued Tax Alert and available at https://www2.deloitte.com/us/en/pages/tax/articles/oregon-supreme-court-upholds-broad-interpretation-of-receipts-from-broadcasting.html.
[3] Oregon's corporate excise tax is imposed on C corporations doing business in Oregon and is measured by net income. See Or. Rev. Stat. ch. 317.
[4] *Comcast Corporation and Subsidiaries v. Department of Revenue*, 363 Or. 537 (August 16, 2018).
[5] *Comcast Corporation and Subsidiaries*, 363 Or. at 551.

[6] The Oregon tax code provides that "'Interstate broadcaster' means a taxpayer that engages in the for-profit business of broadcasting to subscribers or to an audience located both within and without this state. The audience or subscribers ratio shall be determined by rule of the Department of Revenue." Or. Rev. Stat. 314.680(3).

[7] *Comcast Corp. v. Dep't of Revenue*, Nos. TC 5265, TC 5346, 2020 Ore. Tax LEXIS at 13-14; *see also* *Comcast Corporation and Subsidiaries v. Department of Revenue*, 363 Or. 537 (August 16, 2018).

[8] *Comcast Corp. v. Dep't of Revenue*, Nos. TC 5265, TC 5346, 2020 Ore. Tax LEXIS at 13-14.

[9] *Id*. at 28.

[10] *Id.* at 35.

[11] *Id.*

[12] *Id.* at 43-56.

[13] *Id.*; *see also Id.* at 73.

[14] *Id.* at 55-56.

[15] *Id.* at 56.

[16] *Id*. at 56-57.

[17] *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768 (1992).

[18] *Comcast Corp. v. Dep't of Revenue*, Nos. TC 5265, TC 5346, 2020 Ore. Tax LEXIS at 64.

[19] *Id.* at 90.

[20] *Id.* at 72-73.

[21] *Id.*

[22] *Id.*

[23] *Id.* at 75

[24] *Id.* at 75-76

[25] *Id.* at 89.

[26] *Id.* at 58-59. In other words, if an item of income is nonbusiness income under the constitutional test, the statutory definition of business income is irrelevant.

[27] *Id.* at 60-61. The Tax Court noted that Oregon's interstate broadcaster apportionment regime only reduces the amount of business income apportioned to Oregon because both the numerator and denominator include receipts from transactions and activities in the regular course of the taxpayer's trade or business.