OREGON STATE BAR

# Taxation Section

VOLUME 13, NUMBER 1 Winter 2010

## In This Issue:

1 State of the State's Settlement Offer Program
5 New Income Tax Increases
8 Senate Bill 880: Oregon's Tax Amnesty Program
10 Governor Vetoes Cuts to BETC
13 Unemployment Taxes and Independent Contractor Status under ORS 670.600
14 Life in Oregon After Presumptively Retroactive Rules – Senate Bill 498 (2009)

**Executive Committee**

Valerie Sasaki
*Chairperson*
Larry J. Brant
*Chair-Elect*
Katherine O. VanZanten
*Past-Chair*
Robert T. Manicke
*Treasurer*
Neil D. Kimmelfield
*Secretary*

***Members***
Steven L. Christensen
David C. Culpepper
Dan Eller
Gwendolyn Griffith
Vivian M. Lee
Mark F. LeRoux
John Anthony Magliana
David C. Streicher
Jeffrey S. Tarr
Michael C. Wetzel
Jeffrey M. Wong
Jennifer L. Woodhouse
Karen J. Lord
*BOG Contact*
Karen D. Lee
*Bar Liaison*

**Newsletter Committee**

Jeffrey S. Tarr
C. Jeffrey Abbott
Neil D. Kimmelfield
David C. Streicher
Laura L. Takasumi
Scott M. Schiefelbein
Steven Nofziger
Joshua Husbands

**Previous newsletters are posted on the Taxation Section website.**

*Articles in this newsletter are informational only, and should not be construed as providing legal advice. For legal advice, please consult the author of the article or your own tax advisor.*

## State of the State's Settlement Offer Program

*By Dan Eller & Katherine VanZanten[1]*

The Oregon Settlement Offer Program (the "Program") is nearing its tenth year in existence. As we near that milestone we look back so we can look forward. The groundwork for this article was laid earlier this year when members of the Oregon Department of Revenue (the "Department") met with members of the Oregon State Bar Taxation Section's Executive Committee (the "Committee"). Intended to cover a number of different topics, including the 2009 Legislative Session, the conversation that day turned to and ended with a discussion of the Program. Given the parties' mutual interest in continuing that conversation and opening it to the entire Section, an informal lunch presentation was organized for April 28, 2009.

Attended by nearly 60 members of the Section, the April 28 luncheon presentation was an excellent example of how our Section (and, in particular, the Committee) has been working to build rapport with the Department, and vice versa. Four members of the Department's Offer Panel led a detailed discussion of the Program, its requirements and scope, and the common errors made by taxpayers and practitioners. In addition to offering our Section valuable information, the Department committed to meeting with Section members to work through current issues, both specific and general. As a result of that commitment, the Department has fielded direct communications from practitioners which, in at least one situation, may lead to some "outside-the-box" thinking with respect to an unusual estate tax settlement offer.

The Committee formed an ad hoc subcommittee of tax attorneys interested in exploring changes to the Program. As members of that subcommittee, we met with two members of the Department's Offer Panel in early August. That meeting led to our writing this article, with the Department agreeing to provide article content and oversight.

This article begins with general background regarding the Program. The article then focuses on the Settlement Offer (the "Offer") review process. Finally, we provide the most-important requirements of the Program along with the Department's "Top Offer Problems." Throughout this article we provide some "Practice Tips" based on the Department's experience and understanding of the Program. Although the

*continued next page*

Department has reviewed these Practice Tips, none of this advice should be construed as coming from the Department.

## Background

The Program was created by the Department, in consultation with members of the Section, earlier this decade. The Department derives its authority to cancel uncollectible taxes from ORS 305.155. That statute provides for both mandatory cancellation authority (generally, if the tax has been delinquent for more than seven years and it is determined to be wholly uncollectible) and discretionary cancellation authority. The Program arises primarily under that discretionary cancellation authority because, as is discussed herein, the tax amount is not cancelled in whole and, for discretionary cancellation, there is no requirement that the tax be outstanding for seven or more years.

The Offer program has matured since its creation. The Department has developed a comprehensive application package which is available on its Web site at http://oregon.gov/DOR/PERTAX/docs/101-157.pdf (the "Application"). Although the Department states that taxpayers may be able to complete the Application without the help of a tax professional, the Department includes in the Application materials its standard form of power of attorney (the Department's "Power of Attorney"), thereby facilitating representation by tax practitioners.

If you practice in the area of tax controversies and collection matters, you should obtain a copy of the Application and review it, as it is likely you will have clients who may benefit from an Offer. Indeed, in the twelve months ending January 2009, the Department received approximately 313 Offers. Of those that went to a final decision, nearly two-thirds were approved by the Department.[2] Although the Department does not track the number of Applications which were submitted by a taxpayer representative, the Department believes approximately 50 - 60% are filed under a Power of Attorney.

## The Offer Process

You should begin by providing a copy of the Application to your client to complete in pencil (or in Adobe). This should be done before your client signs the Application on Page 14. You should review the entire draft Application. Focus your client's attention on any missing items and on the other important issues set forth in detail below. Once your client has completed the Application to your satisfaction, have the client sign the final draft. This should be the first time your client has signed the Offer.

***Practice Tip*:** Many, if not most, taxpayers will come to you for an Offer because they have fallen woefully out of compliance with tax laws generally. Presume they have bad habits. To begin the process of improving those habits, use the "penalties of perjury" proviso above the signature line to grab their attention regarding the consequences of continued bad habits.

The Department will take questions from practitioners during the preparation of the Application. Questions may be emailed to settlement.questions@state.or.us. You may also speak with a member of the Offer department ((503) 945-8359).

***Practice Tip***: The Department invites practitioners to contact the Department as early as the client intake meeting to discuss questions regarding a possible Offer Application. We recommend against (1) early contact with the Department before all facts are known, and (2) contact with the Department in the presence of your client, at least initially. Seemingly straight-forward collection matters may have criminal tax issues not readily ascertainable upon first review of the facts. Discussing the case with the Department or any third party in these early stages may be unwise.

When the Department receives an Offer (including the required 5% down payment), the Offer is forwarded to one of three processing agents. These agents are charged with reviewing the Offer packet to ensure each of the requirements of the Program is satisfied. If the reviewing agent has any questions or comments regarding the Offer, the agent will either telephone or write *the taxpayer*, but not the taxpayer's representative.

***Practice Tip***: Tax practitioners who work primarily on federal tax controversies may be surprised to learn that the Department's Power of Attorney affords the representative less information than a Treasury Form 2848 Power of Attorney. Unlike a Form 2848, the Department's Power of Attorney does not guarantee the representative will receive copies of Department communications to the taxpayer. In fact, the Department will only copy the representative in unusual circumstances, usually upon the request of the representative for specific information. Your engagement agreements should include a requirement that clients undergoing an Oregon tax collection matter must provide you with copies of all Department correspondence. Remind your clients of this obligation regularly. Failure to respond

to such communication can lead to denial of the Application.

Once the reviewing agent has a complete Offer packet, he or she will submit the Offer along with his or her recommendation on approval or denial to the Offer Panel. The Offer Panel meets every other week to discuss each Offer then ready for a decision. Approval of each Offer requires a unanimous vote at this stage; without it the Offer is transferred to the three Collection Section Managers to review and offer advice. Additional questions or requests for information may be forwarded to *the taxpayer* before a decision is ultimately reached.

An accepted Offer means the taxpayer must perform as outlined in the Offer's terms and conditions, which are set forth on Page 14 of the Application. Specifically, the taxpayer must (1) pay the remaining portion of the Offer amount; (2) file all required returns for the next three years; (3) make all required payments under those returns within 90 days of filing each return; and (4) forgo all appeal rights.

***Practice Tip***: You should counsel your client early and continuously regarding the strict requirements for continued tax compliance for at least the three years following the Offer. Part of your representation must include counseling on the consequences of not changing bad behavior. Your clients' failure to change will mean their Offers will not be successful, and all cancelled tax, penalty, and interest amounts may be reinstated.

A denial means the Offer is no longer valid, and no appeal is possible. The Department applies the 5% down payment (discussed below) to the taxpayer's outstanding tax liabilities. Although a taxpayer may reapply, a new 5% down payment must be filed with each new application. The denial should be accompanied by a detailed explanation, down to the penny, why the Application was denied. The reasoning supporting the denial is critical to your client: this is why you must be copied on all communications from the Department. As is discussed below, some Offers are denied for failure to respond to requests (even simple requests, such as for copies of recent bank statements).

***Practice Tip***: If the reviewing agent will not copy you on his or her communications to your client (which is the Department's policy) and you are not confident your client will provide you this information, you should plan to touch base with the agent at least every two weeks.

Finally, the collection process does not stop during the Offer review process. The Department's collection activity will continue unabated until the Offer is approved and accepted.

***Practice Tip***: Counsel your client regarding ongoing collection during the review process. Having made a 5% down payment, your client may be upset to have his or her personal checking account or other financial institution account garnished during the review process. You can minimize your client's dissatisfaction with *you* by warning of this possibility. You can also help your client seek a hardship exception during the pendency of the Application review process.

## Offer Requirements and Common Errors

The Department has provided a highly detailed, 16-page Application. Despite that effort, the Department continues to receive a number of incomplete Applications. Failure by a taxpayer to complete these Applications properly leaves the Department with no choice but to deny the Application. We asked for, and the Department provided, the requirements of the Program most often missed or misunderstood by taxpayers. The Department gave many examples of common errors, each of which is described below.

**Prerequisites.** Before the Department can review an Offer, the taxpayer must be in compliance with all applicable Oregon tax return filing requirements for all prior tax years. If the taxpayer has not filed all of his or her returns, that is cause for immediate rejection of the Offer. All appeal rights (but not all applicable statutes of limitation) for each filed return must be expired. All blanks in the Application must be filled in, including all signatures lines. As noted above, the taxpayer must include the required 5% down payment. Taxpayers must also respond to Department requests for further information. Failure to respond will result in the Department rejecting the Offer.

**The Offer Amount Must Be A Positive Amount.** An Offer amount of zero is not acceptable. The taxpayer must use the formula in Section 6 of the Application. In calculating the inputs requested in the Offer, the taxpayer cannot use negative equity. This is true both for Oregon Offers as well as the Federal Offer in Compromise. For example, in the event the taxpayer's mortgage on the residence exceeds the fair market value of such residence, the "equity" column should state "0" and not a negative number.

**Application Calculations Must Be Honored.** According to the Department, many taxpayers complete the Offer formula in Section 6 of the Application and then decide to offer a different amount. This is not allowed. The Department will check the formula and an offer of less than the "total offer settlement amount" on line 5 of this section will be rejected.

***Practice Tip***: One concern voiced at the April 28 luncheon was that all of the possible expense categories are not captured in the Application. In particular, we asked regarding how an Internal Revenue Service ("IRS") Offer in Compromise liability should be treated. The Department prefers to see this item identified on Line 67, "Other Expenses." This should be explained in the Application or the attached cover correspondence (see below).

**All Assets Must Be Included.** Many taxpayers exclude assets. For example, taxpayers exclude business income or the value of stocks and bonds they own. If the Department discovers the taxpayer has not disclosed all of his or her assets, the Department may deny the Offer out of hand.

***Practice Tip***. Despite all of your efforts, one of your clients is likely to think he or she can beat the system. Being presented proof of additional assets by the Department can be professionally embarrassing. In addition to leveraging the "penalties of perjury" requirement of the Application, hit your client in the checkbook: inform your client that the Application can be denied and the 5% down payment retained (and not applied to a future Application) if they are dishonest and attempt to hide assets.

**Provide All Required Substantiation**. Common errors include underreported income and the failure to supply documentation to support the income and expense items set forth in the Application. The taxpayer must verify each line item included in the Offer. For example, all expenses for child support, IRS installment payment agreements, and restitution should be included to support the taxpayer's claim of these expenses. The Application requires certain items of substantiation, including but not limited to: three months' proof of payment of insurance premiums; estimated-tax and court-ordered payments; garnishments; child-care; and other miscellaneous expenditures. At the minimum, your client must provide that substantiation at the time of filing the Application. If the Department requests additional substantiation, the default response should be delivery of the requested information.

**Use the Application to Explain Unusual Circumstances**. As previously discussed, the Department must default to the Application's calculations. The Application, however, asks for information in a "flat" manner. For example, if a taxpayer's income is cyclical and he or she earns substantial funds during the summer months but nothing in the winter, the Application and the substantiation may not match. That being said, the Department will allow the taxpayer to average the monthly income for purposes of the Offer. You should provide an explanation of these unusual circumstances.

***Practice Tip***: We submit each Offer under cover correspondence, which is incorporated by reference into the Application with an express statement to that effect in Section 7. That reference is reiterated in the attached cover correspondence. We will then explain in detail any unusual circumstances and advocate the proper decision with respect to each of those in that correspondence.

**Improper Use of National Standards**. The Department uses the "national standards" developed by the IRS for housing, transportation and household expenses when evaluating an Application. If the taxpayer uses the maximum expenses allowed under the national standards, he or she must still substantiate those expenses. The Department has one important exception: if the taxpayer owns a vehicle outright, that individual may claim the actual operating expenses only for that vehicle, and those expenses must be substantiated.

***Practice Tip***: The Department may or may not allow expenses which exceed the threshold set by the IRS. Use your cover correspondence incorporated by reference into the Application to explain these differences, and to advocate for the variance.

**Applying "Prematurely."** If unemployment income is the taxpayer's only income, the Offer will be rejected. The Department would like evidence of a stable income for the months before submission of the Application. For this reason, the Department reiterates its invitation to contact it with questions regarding uncertain issues.

## Looking Ahead

During this process, we have identified a number of important issues to consider when counseling your client regarding the propriety of making an Offer. In particular, we believe we can dispel the notion that the Program is "broken" or operated "arbitrarily" as we

heard leading up to and during the April 28 luncheon. The Department assures us the Program is operated as objectively as possible, and within the general guidelines it has provided in the Application. In addition, the Department's Settlement Panel attempts to track novel issues so that those will be handled consistently.

Looking forward, the Program will likely continue to evolve. For example, we would like to see changes made regarding the Department's policy of not providing copies of communications to taxpayers otherwise covered by a Power of Attorney. Even a warning of this fact in the Application would help put taxpayers and their representatives on notice.

We expect you may have comments and recommendations as well. The Department remains committed to working with the Section's ad hoc subcommittee on this topic. If you would like to participate in this subcommittee, or if you simply want to make a recommendation, please contact either of us or a member of the Section's Executive Committee (please see the front cover of this issue for the names of those volunteers).

**Endnotes**

1 Katherine VanZanten and Dan Eller are attorneys in the Portland office of Schwabe, Williamson & Wyatt specializing in tax transactional and controversy (including collection) matters. Katherine is a past Chair of the Section, and Dan is a member of its Executive Committee.

2 One hundred thirty-five Offers were approved, 64 were denied, and 39 were withdrawn. The remaining Offers were still under advisement as of January 2009.

# New Income Tax Increases

*By Eric Kodesch**

According to Governor Ted Kulongoski's budget for 2009-2011, approximately 94% of the Oregon General Fund, the primary source for discretionary spending in the Oregon budget, comes from the corporate excise tax[1] and the personal income tax. The current global financial downturn, particularly job losses, has broad implications, therefore, on Oregon's expected revenues for the General Fund during the 2009-2011 period. The Oregon legislature has responded by passing various laws, including a fundamental overhaul of the minimum tax on corporations, the creation of a minimum tax for partnerships transacting business in Oregon, and temporary increases in the top marginal corporate and personal income tax rates. These laws seek to shore up the General Fund in a manner that maintains a balanced budget.

## Corporate Minimum Tax

Oregon has had a corporate minimum tax since 1929;[2] the minimum tax has been codified in ORS 317.090 since 1954. Although originally set at $25, the amount of the minimum tax has remained $10 since 1932. This low dollar amount has been a source of controversy for several years.[3] Despite criticism of the tax, however, it remained unchanged through 2008.

During the 2009 legislative session, a number of different proposals arose for changing the minimum tax. Most of these measures involved the creation of a tiered minimum tax based on sales.[4] These proposals offered the simplicity of a flat dollar amount, with limited flexibility to impose a higher minimum tax on corporations perceived to be more successful. For example, House Bill 2119 would have replaced the corporate minimum tax with a tiered tax based on Oregon sales. The amount of tax ranged from $25 for corporate taxpayers with Oregon sales of less than $50,000 to $5,000 for corporate taxpayers with Oregon sales of $1,000,000 or more.[5]

In addition to a minimum tax imposing one or more flat dollar amounts based on sales, the legislature, in House Bill 2070, proposed replacing the present minimum tax with a minimum tax of 0.2% of the "enterprise value tax base" apportioned or allocated to Oregon.[6] For purposes of this tax, enterprise value tax base equaled the sum of (1) compensation paid or accrued, (2) interest paid or accrued, and (3) dividends paid. This new regime would have raised several complicated issues. For example, although there is a general understanding of the items constituting the base of the tax (compensation, interest, and dividends), misunderstandings and differences in reporting these

amounts likely would have arisen in various situations. In fact, a substantially similar tax in New Hampshire consists of 18 sections of the New Hampshire tax code and 16 administrative rules.[7] In addition, this tax would have required taxpayers to undertake calculations not otherwise done for federal income tax or Oregon corporate tax purposes. Accordingly, the new tax likely would have imposed a significant oversight burden on the Oregon Department of Revenue (the "Department"). Ultimately, the bill died in committee.

Instead the legislature passed, and Governor Kulongoski signed into law, House Bill 3405 (Or Laws 2009, ch 745), which adopts a tiered structure based on a corporation's total Oregon sales. The law, which is effective for tax years beginning on or after January 1, 2009,[8] replaces the $10 minimum tax with the following tiered system:

| Amount of Total Oregon Sales | Minimum Tax |
|---|---|
| Less than $500,000 | $150 |
| $500,000 – less than $1,000,000 | $500 |
| $1,000,000 – less than $2,000,000 | $1,000 |
| $2,000,000 – less than $3,000,000 | $1,500 |
| $3,000,000 – less than $5,000,000 | $2,000 |
| $5,000,000 – less than $7,000,000 | $4,000 |
| $7,000,000 – less than $10,000,000 | $7,500 |
| $10,000,000 – less than $25,000,000 | $15,000 |
| $25,000,000 – less than $50,000,000 | $30,000 |
| $50,000,000 – less than $75,000,000 | $50,000 |
| $75,000,000 – less than $100,000,000 | $75,000 |
| $100,000,000 or more | $100,000 |

In addition, the new minimum tax imposes a tax of $150 on an S corporation[9] and on "[e]ach partnership transacting business in this state."[10] "Partnership" presumably includes limited liability companies treated as partnerships for federal and state tax purposes.

For purposes of this tax, total Oregon sales generally equals the amount of Oregon sales calculated pursuant to ORS 314.665 for purposes of determining the Oregon apportionment factor under Oregon's adoption of the Uniform Division of Income for Tax Purposes Act ("UDITPA").[11] The Department is to provide rules for determining the total Oregon sales of a corporation that apportions its business income using a method other than that prescribed by UDITPA.[12] If a corporation is engaged in business only in Oregon, and thus does not apportion its income pursuant to UDITPA or some other apportionment system, Oregon sales equal the amount that would have been calculated pursuant to ORS 314.665 if the corporation were required to apportion its income.[13]

Not all Oregon taxpayers do or would apportion income using UDITPA methods of apportionment. For example, "income from business activity as a financial organization or as a public utility" is apportioned pursuant to rules adopted by the Department, not UDITPA.[14] Similarly, insurance companies do not use UDITPA apportionment.[15] The new rule for determining total Oregon sales for a corporation that does not apportion its income appears to have anomalous results for a corporation that would not use UDITPA apportionment if it did apportion its income. The definition of Oregon sales includes the following:

> "If the corporation does not apportion business income for Oregon tax purposes, the total sales in this state that the taxpayer would have had, as determined for purposes of ORS 314.665, if the taxpayer were required to apportion business income for Oregon tax purposes."

Because ORS 314.665 would not apply to this type of corporation if it "were required to apportion business income for Oregon tax purposes," the Oregon sales determined pursuant to ORS 314.665 arguably would be $0, resulting in a minimum tax of $150. Alternatively, the rule could subject the corporation to UDITPA. This would conflict with the prior legislative decision exempt from UDIPA the type of business engaged in by these corporations.

## Establishment of Graduated Corporate Tax Rates

In addition to increasing the minimum tax applicable to corporations, House Bill 3405 also established graduated corporate tax rates, effectively increasing rates for higher-income corporate taxpayers. For tax years beginning on or after January 1, 2009 and before January 1, 2011, the existing 6.6% rate applies only to the first $250,000 of taxable income; for higher amounts, the rate is 7.9%.[16] For tax years beginning on or after January 1, 2011, and before January 1, 2013, the top rate is reduced from 7.9% to 7.6%, but it still applies to amounts in excess of $250,000.[17] For tax years beginning on or after January 1, 2013, the top rate remains 7.6%, but it applies only to amounts in excess of $10 million.[18]

## New Top Marginal Personal Income Tax Rates

During the 2009 legislative session several bills were proposed to increase the top marginal personal income tax rate. These bills generally were substantially similar in that they would have subjected income in excess of a certain amount to a tax rate above the prior top marginal rate of 9%. One proposal, House Bill 2652, in addition to creating a new top marginal personal income tax rate, also would have expanded the scope of the 5% and 7% marginal tax rates and thus would have raised the income threshold to which the 9% marginal rate applied. Ultimately, the legislature passed, and Governor Kulongoski signed into law, House Bill 2649 (Or Laws 2009, ch 746).

This law increases personal income tax rates for single taxpayers with taxable income above $125,000 ($250,000 for taxpayers filing a joint return). For 2009, the law adds a marginal rate of 10.8% for a single person with taxable income over $125,000 but not over $250,000 (for joint returns, $250,000 and $500,000, respectively) and a rate of 11% for a single person with respect to taxable income over $250,000 (for joint returns, $500,000).[19] For 2010 and 2011, the 10.8% rate is reduced to 9.9% and the 11% rate is eliminated.[20] Accordingly, in these two years, the law imposes a 9.9% marginal rate on income over $125,000 (for joint returns, $250,000). For 2012 and thereafter, the top marginal rate returns to 9%. Unlike the lower rate brackets, the new brackets created by the law are not indexed for inflation.[21]

## Conclusion

During these times of economic difficulty and high unemployment, Oregon's reliance on taxes based on net income to provide revenues for the General Fund becomes problematic. Governor Kulongoski and the Oregon legislature have responded by increasing the minimum tax applicable to corporations, imposing a minimum tax on S corporations and partnerships doing business in Oregon, and raising the marginal tax rate on higher income corporations and individuals. While these steps may have balanced the budget, the changes may not take effect. Two ballot measures to repeal these tax increases are scheduled for January 2010. If the increases are defeated at the polls, then replacing the revenue expected from these 2009 laws will occupy nearly all of the attention of the 2010 short legislative session presently scheduled for February 2010.

**Endnotes**

* Eric Kodesch is an attorney at Stoel Rives LLP in Portland, Oregon. The author thanks Robert Manicke for his assistance with this article.

1 Most corporations subject to Oregon tax pay the Oregon corporate excise tax. Oregon also imposes a corporate income tax on corporations with Oregon-source income that are not subject to the excise tax. For purposes of this article, references to the Oregon "corporate tax" include both excise and income tax.

2 See Or Laws 1929, ch 427, § 6.

3 See Put Schools (Really) First, The Oregonian, Mar. 2, 2005, at C10 (characterizing tax as "Oregon's absurdly low $10 corporate minimum tax"); Charles Sheketoff, Tax Protest Helps Big Business, The Statesman Journal (Salem, Or), Sept. 18, 2003, at 7C ("PGE/Enron and two-thirds of Oregon's corporations recently have been able to get away with paying Oregon's $10 corporate-minimum tax, which is less tax than is paid by unemployed workers.").

4 This article uses the term "tiered" to distinguish from a "progressive" tax system. Generally, in a progressive tax regime the same tax is imposed on each dollar in a bracket against which tax is measured (e.g., net income or sales) with subsequent brackets subject to a higher tax rate. For example, under the federal progressive income tax, a taxpayer at the top of the second tax bracket and taxpayer at the bottom of the third tax bracket will have a nearly identical tax liability. In a tiered system, however, one extra dollar of sales or net income that puts a taxpayer in the next tier significantly increases the tax liability.

5 To further illustrate the difference between a "progressive" tax system and a "tiered" tax system, House Bill 2119 would have imposed a $1,500 minimum tax if the corporation had less than $1,000,000 of sales, but $5,000, if the corporation had $1,000,000 or more of sales. Accordingly, $1 of Oregon sales increasing total Oregon sales from $999,999 to $1,000,000 would have increased the minimum tax by $3,500.

6 HB 2070 § 3(1).

7 See NH Rev Stat Ann § 77-E:1 to 77-E:14; NH Code Admin Ann §302.01-.16.

8 See Or Laws 2009, ch 745, § 4.

9 See Or Laws 2009, ch 745, § 1(2)(b).

10 Or Laws 2009, ch 745, § 3.

11 See Or Laws 2009, ch 745, § 1(1)(a).

12 See Or Laws 2009, ch 745, § 1(1)(c).

13 See Or Laws 2009, ch 745, § 1(1)(b).

14 ORS 314.280(1).

15 See ORS 317.660, "Allocation of net income where insurer has both in-state and out-of-state business."

16 Or Laws 2009, ch 745, § 1(1)(b).

17 See Or Laws 2009, ch 745, §§ 5, 6.

18 See Or Laws 2009, ch 745, §§ 7, 8.

19 See Or Laws 2009, ch 745, §§ 9, 10.

20 See Or Laws 2009, ch 746, § 1.

21 See Or Laws 2009, ch 746, § 2.

22 See Or Laws 2009, ch 746, § 1.

# Senate Bill 880: Oregon's Tax Amnesty Program

*By Amy H. Zubko*[1]

With the passage of Senate Bill ("SB") 880, Oregon adopted its own tax amnesty program. Tax amnesty programs have been utilized in forty-three states over the last thirty years, including Massachusetts, New Jersey, and California. For taxpayers who qualify, the Oregon amnesty program provides a waiver for all penalties and 50% of interest.[2]

The amnesty legislation has not yet been codified in the Oregon Revised Statutes, although the Oregon Department of Revenue ("Department") has released a temporary rule, OAR 150-305.100-(C), that provides general guidance.

Oregon's amnesty program is available to residents and nonresidents for all open tax years beginning prior to January 1, 2008. In general, the program applies to taxpayers who either neglected to file a return or who filed a return but under reported income.[3] Taxpayers who have filed for federal bankruptcy protection may participate in the program if they receive permission from a U.S. Bankrupcy Court.[4] Amnesty is not available for tax years already covered by a failure to file assessment or a notice of deficiency.[5] For example, if a taxpayer has received a notice of deficiency for the 2007 tax year but not the 2006 tax year, the taxpayer may still file under the amnesty program for the 2006 tax year but not the 2007 tax year.

Amnesty relief is available for personal income taxes, corporate income and excise taxes, trust and estate income taxes, inheritance taxes (for returns due before January 1, 2008), and Lane and Tri-Met Transit District self-employment taxes.[6] Payroll taxes are excluded.

## Tax Amnesty Timeline

Applications to participate in the tax amnesty program must be filed between October 1, 2009 and November 19, 2009. (The Department published the application for the amnesty program on the website www.oregontaxamnesty.com on September 18, 2009.) The related tax returns (or amended tax returns) must be filed no later than January 19, 2010.[7] Unless the taxpayer applies for an installment plan beforehand, the delinquent tax liability and the 50% of the interest that is not waived under the program must be paid by the same date. Returns postmarked after January 19, 2010 will be processed as if there were no amnesty program. Waiver of penalties and 50% of the accrued interest are effective only after the Department's receipt of the delinquent tax liability and 50% of the accrued interest.[8]

## Installment Agreements

If application for an amnesty installment agreement is made by January 19, 2010, the taxpayer may make payments over an extended period of time ending May 31, 2011.[9] In general, if a taxpayer defaults on the installment payments, the amnesty-related waiver of penalties and interest is rescinded. However, if the Department finds there was "reasonable cause" for the failure to comply, the installment agreement may be reinstated.[10] Reasonable cause exists when the taxpayer "exercises ordinary care and prudence in abiding by the terms of the installment agreement" but is unable to comply because of the taxpayer's individual circumstances.[11] Factors relevant to reasonable cause include: death or serious illness of a participant or immediate family member; destruction by fire, a natural disaster, or other casualty of the taxpayer's home or place of business; the taxpayer's unavoidable and unforeseen absence from Oregon immediately prior to the payment due date; an unplanned and significant change in the taxpayer's financial circumstances affecting the ability to pay both living expenses and the installment payments; and erroneous written information from the Department.[12] Reliance on an employee or tax professional to pay the liability does not constitute reasonable cause. Nor does the taxpayer's inability to pay the amnesty liability, or failure to pay by oversight.[13]

## Burdens/Pitfalls of the Tax Amnesty Program

Along with the benefits provided, the amnesty program presents several disadvantages. One issue is that taxpayers who participate in the program forfeit their right to appeal or receive a refund for tax years filed under the amnesty program.[14] A more troublesome concern is the 25% penalty imposed if a taxpayer who would have qualified for amnesty declines to apply or participates but under reports the tax liability.[15] Further, the Department will impose the 25% penalty in connection with several other penalties, including ORS 314.402 (substantial understatement of income);

ORS 305.265 (failure to file a report or return with intent to evade tax); ORS 314.403, 314.404 or 314.406 (abusive tax avoidance transaction); ORS 314.075 (evasion of any requirement of any law imposing income taxes); ORS 305.815 or 305.265(13) (filing a false return or report); ORS 118.260, 305.992, 314.400(2) or (3) (failure to file); or a finally imposed penalty under IRC 6662, 6662A, 6663, or 7201.[16]

In limited circumstances the Department will not impose the 25% penalty, including de minimus errors or omissions; arithmetical or transposition errors; or inadvertent errors made in calculating depreciation deductions.[17] It should be noted that there is no exception for taxpayers taking a reasonable reporting position which is challenged by the Department.

The temporary guidance of OAR 150-305.100-(C) will be further enhanced by a permanent rule scheduled to be released after the January 19, 2010 deadline for filing returns has passed.[18]

In conclusion, taxpayers participating in the amnesty program have the opportunity to minimize their interest and penalty liability for their failure to file or under reporting their income; however, the shadow of the 25% penalty will linger for several years as audit adjustments are made on pre-2009 tax years. As a result, taxpayers and tax professionals should continue to monitor future updates and administrative rules.

**Endnotes**

1 Amy H. Zubko is a Portland, Oregon attorney emphasizing federal, state and local taxation.

2 Senate Bill 880, Sec. 3(1), 2009 Leg., 75th Sess. (Or. 2009).

3 Senate Bill 880, Sec. 2(1)(c), 2009 Leg., 75th Sess. (Or. 2009).

4 Senate Bill 880, Sec. 2(3), 2009 Leg., 75th Sess. (Or. 2009).

5 Senate Bill 880, Sec. 2(2), 2009 Leg., 75th Sess. (Or. 2009).

6 Senate Bill 880, Sec. 2(1)(a), 2009 Leg., 75th Sess. (Or. 2009).

7 Senate Bill 880 requires the taxpayer to file returns and make payment "within 60 days" of November 19, 2009 which is January 18, 2010. Senate Bill 880, Sec. 2(1)(c), 2009 Leg., 75th Sess. (Or. 2009). The Oregon Tax Amnesty website, www.oregontaxamnesty.com/ (last visited October 10, 2009), however, indicates that the period ends January 19, 2010, presumably because January 18, 2010 is Martin Luther King Day.

8 OAR § 150-305.100-(C)(5).

9 OAR § 150-305.100-(C)(4)(a).

10 OAR § 150-305.100-(C)(4)(a)(B).

11 OAR § 150-305.100-(C)(4)(b).

12 OAR § 150-305.100-(C)(4)(c).

13 OAR § 150-305.100-(C)(4)(d).

14 Senate Bill 880, Sec. 2(4), 2009 Leg., 75th Sess. (Or. 2009).

15 Senate Bill 880, Sec. 4(1), 2009 Leg., 75th Sess. (Or. 2009).

16 OAR § 150-305.100-(C)(7)(c).

17 OAR § 150-305.100-(C)(7)(b)(A-C).

18 Conversation with Steve Purkeypile, Oregon Department of Revenue (10/14/2009).

## Who Should be Honored with the Taxation Section Award of Merit?

The Executive Committee of the OSB Taxation Section would like to recognize and honor those among us who exemplify professionalism in the practice of tax law in the State of Oregon. In 2009, we presented the Taxation Section's first Award of Merit to David Culpepper. We are now accepting nominations for the Taxation Section's second Award of Merit.

Nominations must be received by February 15, 2010. There is no guaranty that an Award will be presented during 2010; the Executive Committee is striving to insure that the Award is only given to candidates who truly deserve it. The Award will be granted to the candidate whom the Committee believes to best personify the Oregon State Bar's Statement of Professionalism and who best serves as a role model for other lawyers. Competence, ethical standards, conduct with others and the courts, and pro bono contributions to the Bar and the tax system are all factors which will be considered. The candidates accomplishments should obviously fall within the tax field. Should the Executive Committee select a recipient, the Award of Merit will be presented at the Tenth Annual Oregon Tax Institute, June 3 – 4, 2010, Multnomah Athletic Club.

Nomination forms can be obtained on the Taxation Section's website at http://www.osbartax.com/. Please send your completed nomination form to me at the email address below. If you are unable to access the form via the website, or if you have any questions, please contact me by email or phone.

Jeff Wong, Professionalism Subcommittee Chair, Phone (503) 206 8233, jeff@jeffwonglaw.com.

# Governor Vetoes Cuts to BETC

*By Nikki E. Dobay**

The Oregon Business Energy Tax Credit (the "BETC") is an incentive to encourage investment in certain renewable energy projects. The BETC was enacted in 1979, but was substantially expanded during the 2001, 2007, and 2008 legislative sessions. In light of recent economic conditions and budgetary constraints, the 2009 legislature felt a need to analyze the costs and benefits of the BETC. Ultimately, the legislature passed a bill that would have cut back certain aspects of the program. The governor, however, vetoed that bill. While the BETC has temporarily remained intact, it is a program that undoubtedly will receive further attention as the state continues to work through the economic and fiscal downturn.

## History and Overview of the BETC

The BETC is a credit against Oregon tax liability available to the owners of certain renewable energy facilities and other environmental conservation projects. As originally enacted in 1979, the BETC was equal to 35 percent of the costs for a qualified facility as certified by the Oregon Department of Energy ("ODOE"). In 1999, the legislature set the maximum amount of costs that ODOE could certify at $10 million.[1] Thus, the maximum amount of BETC following the 1999 legislative session was $3.5 million.

In 2001, the legislature added the pass-through option, which allows a project owner to sell the BETC to third parties. ODOE interprets the 2001 legislation as allowing a BETC to be transferred only once, pursuant to a process by which ODOE issues a final certificate to the purchaser of the BETC. ODOE sets the transfer price for the BETC.

During the 2007 regular session, the BETC was increased from 35 percent to 50 percent of the certified costs for renewable energy resource facilities,[2] and the maximum amount of costs that ODOE could certify was increased from $10 million to $20 million. The BETC was also expanded to include solar and other renewable energy resource equipment manufacturing facilities. Thus, following the 2007 legislative session, the maximum BETC for renewable energy resource facilities and renewable energy resource equipment manufacturing facilities was increased from $3.5 million to $10 million.

During the 2008 special legislative session, the legislature granted an enhanced benefit specifically for renewable energy resource equipment manufacturing facilities, increasing the maximum amount of costs that ODOE could certify from $20 million to $40 million. Thus, the maximum amount of the BETC for these facilities was increased to $20 million. For those facilities, the legislature also required that certain economic benchmark and employment conditions be met.

Therefore, following the 2008 legislative session, the BETC provided the following benefits:

- 50 percent BETC for renewable energy resource facilities and renewable energy resource equipment manufacturing facilities
  - For renewable energy resource facilities, up to $20 million per facility of costs may be certified by ODOE, and the maximum amount of credit is equal to $10 million.[3]
  - For renewable energy resource equipment manufacturing facilities, up to $40 million per facility of costs may be certified by ODOE, and the maximum amount of the credit is equal to $20 million[4]
- 35 percent BETC for other energy projects
  - Up to $10 million of costs may be certified by ODOE, and the maximum amount of credit is equal to $3.5 million[5]

For qualifying facilities, a two-stage certification process is required. First, the owner of a facility that is eligible for the BETC must apply for preliminary certification before the owner financially commits to start construction of the facility.[6] ODOE issues the preliminary certification, which states the dollar amount of the costs that ODOE expects to certify based on estimated cost data provided on the application.[7] For the BETC to actually be claimed on a tax return, ODOE must issue a final certificate after the facility is complete and the developer files a second application disclosing the actual costs of construction.[8] The amount of BETC that is shown on the final certificate can vary by as much as

10 percent (higher or lower) from the estimated costs that were precertified.[9]

Upon final certification, the BETC is claimed by either the project owner or the pass-through partner (if the BETC is transferred) over a five-year period.[10]

Prior to the 2009 legislative session, the BETC was to sunset on January 1, 2016.[11]

## The 2009 Legislative Session

The 2007 and 2008 changes resulted in a significant increase in wind, solar, and other renewable energy projects in Oregon.[12] In light of the economic conditions and budgetary constraints facing Oregon, modification of the BETC was a key issue during the 2009 legislative session. Legislators introduced 13 bills that would have amended the BETC. Three were signed into law, and one was passed by the legislature but later vetoed by the Governor. The three bills that were enacted into law modestly reduce the BETC benefits. They are HB 2067 (Or Laws 2009, ch __), HB 2068 (Or Laws 2009, ch __), and HB 2078 (Or Laws 2009, ch __).

HB 2067 creates or adjusts the sunset provisions for most personal income and corporation excise tax credits that are not required under federal law or the Oregon Constitution. HB 2067 adjusts the BETC sunset date from January 1, 2016 to January 1, 2012.

Pursuant to HB 2068, only C corporations, S corporations, or personal income taxpayers may purchase a BETC, and sales to partnerships are not allowed. In addition, a BETC may be sold only once, unless expressly provided otherwise by statute. Finally, HB 2068 requires ODOE to set the transfer price for the BETC. This transfer price is to be recalculated quarterly and must take into account inflation and rates of return. HB 2068 is effective January 1, 2010.[13] HB 2068, which is intended to prohibit transfers of credits to partnerships, seems to preclude any attempt to monetize the BETC through the sale of partnership interests.[14] In addition, ODOE is now required, where previously it was given discretion, to set the transfer price of the BETC. While ODOE currently uses its discretion to set the transfer price for the BETC, starting January 1, 2010 it will be required to recalculate the transfer price on a quarterly basis.

HB 2078,[15] repeals the BETC for non-plug-in alternative fuel vehicles purchased after December 31, 2009.[16]

HB 2472 was the key BETC bill during the 2009 legislative session. HB 2472 was the subject of numerous public hearings and work sessions in which the House Revenue and the Senate Finance and Revenue Committees weighed the purpose of the BETC against the current budgetary issues facing Oregon. HB 2472 was passed by the legislature on July 1, 2009. On August 7, 2009, the Governor vetoed HB 2472.

Overall, HB 2472 would have provided significant cutbacks to the BETC, with the exception of adding a new type of renewable energy resource equipment manufacturing facility. HB 2472 would have:

- established an enhanced certification process for projects in excess of $5 million, similar to the enhanced certification process for renewable energy resource equipment manufacturing facilities. HB 2472 would have allowed ODOE to impose certain conditions upon such projects, and revoke a BETC if those conditions were not met;
- allowed manufacturers of electric vehicles a 50 percent BETC on a maximum of $40 million of eligible costs;
- decreased the maximum amount of eligible costs that could be precertified from $20 million to $10 million for facilities that use or generate a renewable energy resource and that have an installed capacity of 10 megawatts or more. Renewable energy resource use or generation facilities with an installed capacity of 10 megawatts or less would have continued to be eligible for the $20 million maximum eligible cost cap;
- reduced the BETC from 50 percent to 35 percent for facilities that use or generate a renewable energy resource that have an installed capacity of 10 megawatts or more. Renewable energy resource use or generation facilities with an installed capacity of 10 megawatts or less would have continued to be eligible for the 50 percent BETC;[17]
- expressly allowed ODOE to treat multiple applications submitted by the same applicant as one application; and[18]
- removed the 10 percent increase in final certification costs.[19]

## Looking Forward to 2010

The legislature is planning to hold a short special session in February 2010, during which the BETC will undoubtedly be a priority. Committee members have

indicated that they will address the 2012 sunset issue; that they will consider the Governor's concerns, which led to the veto of HB 2472, as they move forward; and that they may introduce a revised version of HB 2472. Thus, while the BETC has survived the 2009 legislative session substantially intact, the legislature is again likely to take a hard look at the program.

**Endnotes**

* Nikki Dobay is an associate at Stoel Rives LLP in Portland, Oregon. The author thanks Robert Manicke for his assistance with this article.

1 See Or Laws 1999, ch 365, § 2.

2 A "renewable energy resource facility" is a facility that uses or generates electricity from a renewable energy resource. ORS 315.354(1)(c). Renewable resources include straw, forest slash, wood waste or other wastes from farm or forest land, nonpetroleum plant- or animal-based biomass, ocean wave energy, solar energy, wind power, water power or geothermal energy, or hydroelectric generating facilities that meet certain federal and state regulatory requirements and do not exceed 10 megawatts. ORS 469.185(12).

3 ORS 315.354(4)(a); ORS 469.200(1)(a) (Or Laws 2008, ch 29).

4 ORS 315.354(4)(a); ORS 469.200(1)(a) (Or Laws 2008, ch 29).

5 ORS 315.354(4)(d).

6 ORS 469.205(1).

7 OAR 330-090-0130(3).

8 ORS 469.215 (Or Laws 2008, ch 29); OAR 330-090-0130(9).

9 ORS 469.215(4) (Or Laws 2008, ch 29). For example, pursuant to this provision, the amount of BETC available for a renewable energy resource equipment facility can be as much as $11 million.

10 ORS 315.315(1). The amount of BETC claimed in each of the five years depends upon the type of project for which the BETC has been issued.

11 ORS 315.357.

12 Testimony, H Comm on Revenue, HB 2472, Feb. 19, 2009 (statement of Mike Grainey).

13 During testimony before the House Revenue Committee on October 1, 2009, Joan Fraser, the Acting Deputy Director of ODOE, stated that ODOE will be publishing regulations on the transfer price for the BETC over the next few months.

14 This is also supported by the fact that HB 2159, which would have allowed a sale, exchange, or other disposition of interests in a partnership or shares in an S corporation to qualify for the purpose of transferring the BETC, died in committee.

15 HB 2078 as introduced would have imposed a cap on the total amount of BETCs that ODOE could award statewide. HB 3444, which was not passed, also would have imposed a cap on the amount of BETCs that could have been awarded.

16 HB 2078 also imposes this limitation on non-plug-in alternative fuel vehicles that would qualify for the Residential Energy Tax Credit, which is known as the RETC.

17 The legislature rejected HB 3291, which would have reduced the amount of the BETC from 50 percent to 35 percent for renewable energy resource facilities. Thus, with the exception of renewable energy resource equipment manufacturing facilities, HB 3291 would have reinstated the BETC to pre-2007 amounts.

18 ODOE has addressed this issue in Temporary Regulations published on November 3, 2009.

19 ODOE has disallowed the 10 percent increase in final certification costs in Temporary Regulations published on November 3, 2009.

# Unemployment Taxes and Independent Contractor Status under ORS 670.600

*Tips to avoid Audit and Considerations for Appeal*

*By C. Jeffrey Abbott, Abbott & Munns LLC*

Some advisors may have had the experience of a client requesting advice on how to respond to an Oregon unemployment insurance tax audit assessment. The client expected that payments documented to the IRS by means of IRS Form 1099 for miscellaneous payments were payments to independent contractors. Oregon's definition of independent contractor for unemployment insurance tax purposes changed effective January 1, 2006, pursuant to ORS 670.600.[1] The revised definition makes the outcome of an independent contractor analysis more likely to be consistent with IRS conclusions about worker payments.

Obviously, clients taking preventative measures will likely fare better in an Oregon Employment Department (OED) audit than those that don't. An audit may very well start as a result of a worker filing for unemployment benefits who innocently lists the client as the person for whom he or she has worked, not thinking about whether that relationship was one of an independent contractor or employee.

Some common doses of preventative medicine for clients include the following:

**Independent contractor agreement.** Clients should maintain an independent contractor agreement with each of their payee workers. The contract terms ought to include the ordinary recitations concerning the parties' relationship and responsibilities for taxes and workers' compensation insurance. Additionally, the contract should contain provisions corresponding to the independent contractor tests in ORS 670.600, including: (i) assurances the worker is free from the direction and control of the payor by specifics such as freedom to hire and fire assistants and scheduling the date and location of work to be performed;[2] (ii) requirements that the worker will obtain all required licenses and affirm licensing, if required for the work;[3] (iii) provisions outlining warranties, correction of defects and fixed price arrangements;[4] (iv) affirmations concerning performance of contract services for others;[5] and (v) worker responsibility for providing tools and/or the facilities where the work is performed, if applicable.[6]

**Engage a business entity.** Consider advising clients to avoid, if possible, engaging a payee who does not operate from a formal entity, such as a corporation or LLC.[7]

**Don't shoehorn workers who don't fit.** Advise clients to pay any workers as employees who obviously fail to meet the tests as independent contractors under ORS 670.600.

**No Form 1099 required**. Just because a worker may be paid less than $600 in a calendar year, which may avoid an IRS Form 1099 reporting requirement, does not mean Oregon unemployment tax is not an issue. The Form 1099 filing threshold is not relevant for Oregon unemployment tax purposes, and OED auditors will generally review both check disbursement registers and filed Form 1099s.

Post audit considerations for advisors include:

**ORS 670.600 Checklist.** Review the statute for <u>each category of worker</u> payments to determine strengths and weaknesses of arguments supporting the independent contractor classification. The OED will attempt to make a client prove each and every worker satisfies the statutory tests. The client's defense to this approach is incredibly burdensome. Try to categorize workers and analyze them as a group selecting representative samples. In a case where 400 payees were in a similar service category, an administrative law judge took testimony of a representative sample and strongly encouraged, in the interest of time and repetitive testimony, the OED to stop parading a long list of witnesses who all had very similar responses.[8]

**Other applicable statutory definitions.** Sometimes a winning argument does not involve disputing ORS 670.600's elements. Failing to satisfy the employment relationship or the definition of employee can also derail the OED. The definition of "employee" in ORS 657.015[9] may be useful in arguing that an employment relationship was never formed (e.g. corporate director payments, payments by agents to clients in the music and arts industries).

**In-person appeals.** Consider avoiding telephonic hearings, as these hearings may be too abbreviated, in most cases, to provide the administrative law judge with sufficient testimony to discredit facts and overturn the auditor's conclusions. Costs for an in-person administrative hearing will most likely increase significantly, so be sure to advise your client of the anticipated costs.

**Hearing record**. Unlike other tax controversies, such as an appeal from an Oregon Department of Revenue audit, the Oregon Court of Appeals hears an appeal from an adverse unemployment tax decision.[10] Consequently, making a good hearing record is important to a subsequent appeal.

#### Endnotes

1 The definition of independent contractor in ORS 670.600 also applies for purposes of Oregon's Workers' Compensation and Income Tax Withholding statutes.

2 ORS 670.600(2)(a), (3)(e).

3 ORS 670.600(2)(c)-(d).

4 ORS 670.600(3)(b).

5 ORS 670.600(3)(c).

6 ORS 670.600(3)(d)(A)-(B).

7 The statute does address formation of entities: "The creation or use of a business entity, such as a corporation or a limited liability company, by an individual for the purpose of providing services does not, by itself, establish that the individual provides services as an independent contractor." ORS 670.600(5)(a)(emphasis added).

8 The author represented a client in this hearing before an administrative law judge. The hearing decision was unreported and it was not appealed to the Oregon Court of Appeals.

9 ORS 657.015 provides: "As used in this chapter, unless the context requires otherwise, 'employee' means any person, including aliens and minors, employed for remuneration or under any contract of hire, written or oral, express or implied, by an employer subject to this chapter in an employment subject to this chapter."

10 Compare ORS 657.684 and 183.482 with ORS 305.265(15).

# Life in Oregon After Presumptively Retroactive Rules – Senate Bill 498 (2009)

*By Valerie H. Sasaki[1], Miller Nash LLP*

One of the hallmarks of good tax policy is predictability in administration. Practically speaking, a taxpayer should be able to rely on the laws in effect at the time of filing his or her tax return. The Internal Revenue Code adopts this approach in IRC § 7805(b), which prohibits any "temporary, proposed, or final regulation relating to the internal revenue laws [from applying] to a taxable period ending before the earliest of the following dates: (A) the date on which such regulation is filed with the Federal Register; (B) In the case of any final regulation, the date on which any proposed or temporary regulation to which such final regulation relates was filed with the Federal Register; or (C) The date on which any notice substantially describing the expected contents of any temporary, proposed, or final regulation is issued to the public." There are narrow exceptions for when the IRS is attempting to "prevent abuse" or "retroactively correct[ing] a procedural defect in the issuance of any prior regulation," but of course these are exceptions.

Historically, the Oregon Department of Revenue has been able to apply new regulations retroactively. Oregon Administrative Rule ("OAR") 150-305.100-(B) states: "Administrative rules adopted by the department, unless specified otherwise by statute or by rule, shall be applicable for all periods open to examination." The Oregon Department of Revenue has repeatedly applied new interpretations of existing laws retroactively to all open years. We saw this most recently in a policy statement on addressing economic nexus in the context of the Oregon Tax Amnesty program.

On May 1, 2008, the Oregon Department of Revenue adopted its economic nexus rule (OAR 150-317.010). This rule states that if certain economic thresholds are met, an out-of-state taxpayer is subject to Oregon income and franchise tax. This is true even if the out-of-state taxpayer has no physical presence in

Oregon. (This rule mirrors a new trend we have seen in other jurisdictions and several recent cases holding that a state does not violate the US Commerce Clause if it seeks to tax an out-of-state corporation with no physical presence in the state, provided that the company has "substantial nexus" with the taxing state.) The Department of Revenue has confirmed that this rule is to be applied to all open tax years.

Because the rule is applied retroactively, Oregon Department of Revenue issued a notice in mid-October that an out-of-state taxpayer that meets the substantial nexus threshold and does not take advantage of Oregon's current tax amnesty program is subject to the 25% "failure-to-participate-in-the-amnesty-program" penalty.

To see how this can create a problem, consider hypothetical taxpayer ABC, Inc. that did not file an Oregon corporate excise tax return in 1992 (The year of Quill Corp. v. North Dakota, 504 US 298), under the theory that it had no physical presence in Oregon. Since the corporation did not file a tax return, the statute of limitations remains open. The Department could assert that ABC, Inc. should have filed and paid Oregon income tax under the new economic nexus rule, assess the tax liability, 17 years of interest, substantial understatement penalties, and (after November 19th) the 25% amnesty penalty.

Recently, the legislature provided limited relief from retroactive regulations. During the 2009 session, the Oregon legislature passed Senate Bill 498 at the initial request of several business groups. This legislation provides that: "The Department of Revenue may not apply an administrative rule in a manner that requires a change in the treatment of an item of income or expense, a deduction, exclusion, credit or other particular on a report or return filed by a taxpayer if: (1) The taxpayer filed the report or return by the date it was due; and (2) The treatment of the item on the report or return was consistent with an administrative rule adopted and in effect at the time that the report or return was filed."

While Senate Bill 498 represents a significant advancement from prior law, it only applies to characterization of items on a tax return blessed by a then current rule. It does not apply to the questions of nexus nor interpretative issues for which there are no rules. Also, it only applies to "administrative rules adopted or amended by the Department of Revenue on or after the effective date of" Senate Bill 498. So, our hypothetical ABC, Inc. is still at risk of a significant assessment, as the economic nexus rules were promulgated prior to the passage of this law.

The Tax Section of the Oregon State Bar is working with the Oregon Department of Revenue on an administrative rule to clarify how the Department interprets its authority in the post-Senate Bill 498 era. Even with added clarity, Oregon taxpayers (and potential taxpayers) are left to wonder if the rules of the game may still change at any time in the future.

**Endnotes**

1 The author thanks Mr. Steven Christensen and Mr. William Manne for their assistance with this article.

Oregon State Bar
**Taxation Section**
16037 SW Upper Boones Ferry Rd
PO Box 231935
Tigard, OR 97281

Presorted Standard
US Postage
**PAID**
Portland, Oregon
Permit No. 341

***Featuring:***

- Benefits *with Mary "Handy" Hevener, Morgan Lewis & Bockius LLP*
- Federal income tax update *with Professor Marty McMahon, University of Florida*
- Tax controversies *with Marc Sellers, Schwabe Williamson & Wyatt PC*
- TICs and real estate workouts *with Kevin Thomason, Thompson & Knight LLP*
- Real estate and partnerships *with Andrea Macintosh Whiteway, McDermott Will & Emery*
- State and local tax *with Prentiss Willson, Ernst & Young LLP*

***Cosponsored by the Oregon State Bar Taxation Section***
**Thursday, June 3 & Friday, June 4, 2010**
**13 General CLE credits (pending)**
**Multnomah Athletic Club, Portland, Oregon**
**Registration opens March 1, 2010**

Early registration (by 5/21/10): $425
Regular registration (after 5/21/10): $445

**Questions?** Contact the OSB CLE Service Center at (503) 431-6413 or toll-free in Oregon (800) 452-8260, ext. 413.

Oregon State Bar CLE Seminars
*Powering Your Professional Development*