

## Oregon Supreme Court Issues Important Decision on Sales Factor Sourcing

April 9, 2015

### Overview

In *Powerex Corporation v. Department of Revenue*, the Oregon Supreme Court provided guidance on two important issues related to Oregon state corporate excise tax apportionment by holding that:

1. Electricity is tangible personal property; and
2. Sales of tangible personal property shipped via pipeline (e.g., natural gas) shall be sourced to the location of the purchaser rather than to a contractually-defined point of delivery.<sup>1</sup>

This Tax Alert summarizes the *Powerex* decision and outlines various considerations for taxpayers.

### Electricity is Tangible Personal Property for Purposes of Oregon's Sales Factor

The taxpayer, a Canadian utility company based in Vancouver, British Columbia, made wholesale sales of electricity across western North America, including the United States. The Oregon Tax Court had previously upheld the taxpayer's argument that its sales of electricity constituted sales of other than tangible personal property.<sup>2</sup> The Oregon Department of Revenue ("DOR") then appealed this decision to the Oregon Supreme Court.

The question of whether electricity is tangible personal property versus intangible property for sales factor purposes has an important impact on the computation of Oregon's state corporate excise tax apportionment factor. More specifically, while Oregon sources sales of tangible personal property to where the property is shipped or delivered to the customer,<sup>3</sup> Oregon sources sales of other than sales of tangible personal property to the location of the income-producing activity based on costs of performance.<sup>4</sup> Because the taxpayer in this case had incurred most of its costs of generating electricity in British Columbia, the Oregon Tax Court's conclusion that its electricity sales constituted sales of other than tangible personal property had allowed the taxpayer to source the electricity sales outside of Oregon for the tax years at issue.

The Oregon Supreme Court examined whether electricity constitutes tangible versus intangible property by analyzing "the context in which the legislature used the word 'tangible'"<sup>5</sup> rather than by looking at the scientific properties of electricity. Based on the court's reading of various authorities, including law dictionaries, treatises, and U.S. Supreme Court decisions, it concluded that "the scientific debate about the subatomic properties of electricity – as fascinating as it is – seems beside the point."<sup>6</sup> In this respect, the court reasoned that the context of Oregon's apportionment statute indicates that electricity should be considered tangible personal property because:

- Electricity is perceptible to the senses, particularly the sense of touch;
- Electricity can be physically located in a state and can be shipped from one state to another; and
- The physical properties of electricity are what make it valuable to the customer.<sup>7</sup>

### Sales of Tangible Personal Property Delivered via Pipeline are Sourced to Location of Customer

The taxpayer also made wholesale sales of natural gas throughout western North America, and its sales of natural gas were shipped to customers via a network of pipelines. These pipelines were organized around regional "hubs" pursuant to federal regulations. The taxpayer's sales to its California customers passed through a hub in Malin, Oregon. Pursuant to underlying contract terms, title to the natural gas transferred to the

<sup>1</sup> *Powerex Corporation v. Dept. of Rev.*, 357 Or. 40 (Mar. 26, 2015).

<sup>2</sup> *Powerex Corporation v. Dept. of Rev.*, 21 Or. Tax 30 (2012).

<sup>3</sup> Or. Rev. Stat. § 314.665(2)(a); Or. Admin. R. 150-314.665(2)-(A).

<sup>4</sup> Or. Rev. Stat. § 314.665(4); Or. Admin. R. 150-314.665(4)(2)-(3).

<sup>5</sup> *Powerex*, 357 Or. 40, at 59, citing, *Yates v. United States*, \_\_\_ US \_\_\_, 135 S. Ct. 1074 (2015).

<sup>6</sup> *Id.*, at 65.

<sup>7</sup> *Id.*, at 66.

taxpayer's customers at the Malin hub. As such, based on these contractual title transfer provisions, the taxpayer had originally filed its Oregon corporate excise tax returns for the tax years at issue by treating these sales as Oregon-sourced sales for sales factor purposes. The taxpayer later filed amended Oregon corporate excise tax returns that sourced these sales outside of Oregon to California (*i.e.*, to where its customers were located). The Oregon Tax Court upheld the taxpayer's sourcing of these sales to California,<sup>8</sup> and the DOR appealed.

At the Oregon Supreme Court level, the DOR did not question whether the taxpayer's natural gas sales were ultimately shipped to California, but instead argued that these sales should nevertheless be sourced to Oregon because:

- The underlying contracts provided that the Malin, Oregon hub was the contractual point of delivery; and
- Title to the natural gas transferred from the taxpayer to the customers at the Malin, Oregon hub.

The Oregon Supreme Court noted that Oregon has adopted the Uniform Division of Income for Tax Purposes Act (UDITPA) as its model for the State's apportionment statutes and that "most legal authorities have acknowledged that . . . the Uniform Act is best read as embodying an ultimate-destination theory of sales apportionment."<sup>9</sup> The court thus observed that the "contractual point of delivery" for the natural gas essentially served the same function as the "f.o.b. point," which Oregon law generally provides shall be disregarded when sourcing sales of tangible personal property.<sup>10</sup>

The DOR made several arguments that the court ultimately rejected. One of these arguments involved interpretation of Oregon's administrative rule on the sourcing of sales of natural gas.<sup>11</sup> The DOR argued that Oregon's administrative rule on point provides that for sales of natural gas, the sale shall be sourced to Oregon if the "contracted point of delivery" is in Oregon.<sup>12</sup> Under this administrative rule, the DOR argued that the hub in Oregon served as the contracted point of delivery and thus the sales must be sourced to Oregon.

The court disagreed, observing that the administrative rule in question is, as applied by the DOR, "squarely inconsistent with the statute . . . [because the administrative rule] gives dispositive effect to the 'conditions of the sale' that ORS 314.665(2)(a) directs us to disregard."<sup>13</sup> In doing so, the court did not invalidate the administrative rule, but instead reinforced that Oregon's ultimate destination sourcing regime, as embodied by its statutes, controls.

## Considerations

The *Powerex* decision raises some interesting considerations for taxpayers beyond just those engaged in the sale of electricity and/or natural gas in that:

- The decision provides guidance that legislative intent and the context of the adoption of specific terms in a statute carry significant weight – even to the point of overriding "scientific debate" as to the true nature or meaning of a term.
- The Oregon Supreme Court determined that Oregon has adopted an ultimate destination regime for sourcing sales of tangible personal property, and the DOR's administrative rules must be read in a manner consistent with this law.

## Contacts

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<sup>8</sup> *Powerex*, 21 Or. Tax 30 (2012).

<sup>9</sup> *Powerex*, 357 Or. 40, at 51.

<sup>10</sup> Or. Rev. Stat. § 314.665(2)(a).

<sup>11</sup> Or. Admin. R. 150-314.665(2)-(C).

<sup>12</sup> Or. Admin. R. 150-314.665(2)-(C)(1).

<sup>13</sup> *Powerex*, 357 Or. 40, at 55.

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