



MULTISTATE INCOME/FRANCHISE TAX

Oregon Tax Court reconsiders decision on apportionment of Subpart F and dividend income Tax Alert

Overview

On October 6, 2021, in [Oracle Corporation and Subsidiaries v. Oregon Department of Revenue](#), the Oregon Tax Court, Regular Division (“Tax Court”), reconsidered cross motions for partial summary judgment involving dividend income and Subpart F income received by Oracle Corporation (“Taxpayer”) from its wholly-owned controlled foreign corporations (“CFCs”) and analyzed whether Oregon law required the portion of dividend income and Subpart F income that is not subtracted from federal taxable income (“Net Dividends”) through Oregon’s dividends-received deduction (“DRD”) to be included in the taxpayer’s sales factor. Net Dividends are the amount of dividends included in Oregon taxable income after application of the DRD. Ultimately, the Tax Court reversed its earlier decision and determined that Subpart F income constitutes apportionable receipts and also denied both parties’ motions on the grounds that the remaining issue, determining the primary business activity of the Taxpayer and its CFCs, was a factual matter.

This Tax Alert summarizes the Tax Court’s decision.

Oregon Tax Court reconsiders motions for summary judgment

Background facts

Taxpayer, a computer technology company, filed Oregon consolidated corporate excise tax returns for tax years ending May 31, 2010, 2011, and 2012 (the “Years at Issue”). On its consolidated corporate excise tax returns for the Years at Issue, Taxpayer sought to include Net Dividends (including certain amounts that were not paid to Taxpayer but were required to be imputed to it pursuant to Subpart F of the Internal Revenue Code). The parties agreed that 80 percent of the Subpart F income and 80 percent of the dividends may be subtracted in computing Oregon taxable income. The parties also agreed Taxpayer must exclude the subtracted 80 percent amount from its sales factor for purposes of apportioning business income to Oregon.

On reconsideration, the Oregon Tax Court was asked to consider “whether the Dividends and Subpart F Income that are attributable to Taxpayer’s unitary CFCs, and are not subtracted from taxable income, are included in Taxpayer’s Oregon sales factor.”

For a discussion of the procedural history and previous Tax Court decision, please see our [previous Tax Alert](#).

Whether the Net Dividends attributable to Taxpayer’s CFCs are included in Taxpayer’s Oregon sales factor?

The Tax Court first reconsidered whether Subpart F income constitutes gross receipts and determined that because “Subpart F functions essentially as a mandatory accounting method” and “the legislature intended ‘gross receipts’ to be construed according to the taxpayer’s tax accounting method,” the Tax Court now agrees that “Subpart F income constitutes gross receipts for apportionment purposes and is treated in the same manner as the Dividends that some of the CFCs actually paid to Taxpayer.” Furthermore, the Tax Court stated that “[a]lthough Subpart F is not framed as an accounting method, its purpose overlaps substantially with that of an accounting method: to ‘clearly reflect’ actual income.”

The Tax Court then considered the parties’ arguments regarding the inclusion of Net Dividends in apportionment. Taxpayer argued that ORS § 317.267(3) required inclusion of Net Dividends not otherwise deducted under the DRD in its Oregon sales factor. ORS § 317.267(3) states “[t]here shall be excluded from the sales factor of any apportionment formula employed to attribute income to this state any amount subtracted from federal taxable income under subsection (2) of this section.” Taxpayer based its argument on the principle of statutory interpretation known as *inclusio unius est exclusio alterius* (the inclusion of the one is the exclusion of the other). The Tax Court found that the statutory language did not specify whether the unsubtracted portions must be excluded from or included in the sales factor. Therefore, the Tax Court turned to the statutory context and concluded that the legislature did not intend ORS § 317.267(3) to address the exclusion or inclusion of the unsubtracted portion of a dividend. Furthermore, the Tax Court stated that the principle *inclusio unius est exclusio alterius* “cannot overcome the strong indicators in the statutory context.” Therefore, the Tax Court denied Taxpayer’s partial motion for summary judgment.

The Department argued that, pursuant to ORS § 314.665(6)(a), the Net Dividends are excluded from sales apportionment because the receipts are generated from the Taxpayer’s holding of CFC stock. ORS § 314.665(6)(a) provided that “sales” excludes “[g]ross receipts arising from the sale, exchange, redemption or holding of intangible assets, including but not limited to securities, unless those receipts are derived from the taxpayer’s primary business activity.” The Tax Court referred to the latter primary business activity clause as the “reinclusion provision.” The Department argued that the Taxpayer’s “primary business activity” is the sale of software and not receiving of dividends from holding stock in a CFC; therefore, the Net Dividends must be excluded from sales.

The Tax Court considered the statutory text and context of the exclusionary provision of ORS § 314.665(6)(a). The Tax Court found that the Taxpayer’s shares of stock in the CFCs are intangible assets within the plain meaning of the statute. The Tax Court then conducted a statutory interpretation analysis of the terms ‘arising from’ and ‘holding.’ The Tax Court concluded that the plain meaning of ‘arising from’ “referred to the immediate ‘sources’ of gross receipts that the legislature ‘specified’ in the same sentence: a sale, exchange or redemption of stock, or the payment of a dividend on stock held by the shareholder.” Furthermore, the Tax Court concluded that the technical legal meaning and plain meaning of ‘arising from’ the ‘holding’ of intangible assets

was that “the gross receipts at issue must originate from the possession or legal ownership of the shares.” As a result, the Tax Court stated that it “accepts that the Dividends and Subpart F income ‘arose from’ Taxpayer’s ‘holding’ of the CFC stock . . . , even though ‘holding’ does not fully capture the depth of a unitary relationship, such as the one between Taxpayer and the CFCs in this case.”

The Tax Court then analyzed the plain meaning of “derived from” and “primary business activity” of ORS § 314.665(6)(a). The Tax Court determined that the technical legal and plain meanings of “derived from” directs the Tax Court “to look to any ‘specified source’ in the statute and to look no further if the statute identifies one.” Further, the “source” is a taxpayer’s “primary business activity.” The Tax Court determined that two things must be compared under the reinclusion provision:

- (1) the primary business activity of the subsidiary that generated the earnings and profits out of which the dividend was paid (or to which any subpart F income is attributable) and
- (2) the primary business activity of the parent.

If the answers to the two inquiries are the same, then the “dividend must be reincluded in the definition of ‘sales’ because the dividend (or subpart F income) is ‘derived from’ the taxpayer parent’s ‘primary business activity.’”

The Tax Court found that the Department misunderstood this required comparison under the reinclusion clause, therefore the Tax Court denied the Department’s motion. The Tax Court stated that “the remaining task is to determine Taxpayer’s primary business activity and to identify whether that activity is the primary business activity of each CFC whose earnings and profits resulted in a Dividend or Subpart F Income for the Years at Issue.” The Tax Court directed the parties to confer and advise the court as to a need for further proceedings to resolve the remaining factual differences.

Considerations

While the Tax Court’s decision provides some clarification regarding how Oregon law disallows the inclusion of un-subtracted amounts of a taxpayer’s Net Dividend income in the apportionment formula, this issue remains a complex and fact-specific question and should be carefully analyzed.

Get in touch

[Scott Schiefelbein](#)

[Sara Clear](#)



30 Rockefeller Plaza
New York, NY 10112-0015
United States

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