OREGON STATE BAR

Taxation Section

VOLUME 15, NUMBER 2 Fall 2012

In This Issue:

Executive Committee

Neil Kimmelfield
Chairperson
Robert Manicke
Chair-Elect
Larry Brant
Past-Chair
Dan Eller
Treasurer
Jeffrey Tarr
Secretary

Members
Patrick Green
Lee Kersten
Mark LeRoux
John Magliana
Ryan Nisle
James Puetz
Barbara Smith
Jeffrey Wong
Jennifer Woodhouse

Hunter Emerick
BOG Contact
Karen D. Lee
Bar Liaison

Newsletter Committee

David C. Streicher, Chairperson
Jennifer Woodhouse
Dallas G. Thomsen
Neil D. Kimmelfield
Laura L. Takasumi
Scott M. Schiefelbein
Steven Nofziger
Joshua Husbands
Hertsel Shadian

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.

Navigating the New BETC Landscape

by Irina M. Antonache[1]

In response to some criticism and unfavorable press coverage surrounding the Oregon Business Energy Tax Credit (BETC) Program, the Oregon legislature passed House Bill 3672 during the 2011 legislative session. HB 3672 not only limited spending under the BETC program but also divided it into three distinct programs: renewable energy generation, conservation, and transportation.[2]

This article discusses the process and requirements for projects under development that have already received preliminary certifications as well as the process and requirements for each of the new renewable energy generation, conservation, and transportation BETC programs. The manufacturing BETC—which provides a credit to a facility that manufactures equipment or machinery designed to use renewable energy resources to generate electricity—was transferred to the jurisdiction of the Oregon Business Development Department[3] and is not covered in this article.

Projects Under Development

Although HB 3672 was not passed until June 30, 2011, and did not take effect until September 29, 2011, to remain eligible for a BETC with respect to a project an applicant must have filed an application for preliminary certification for the project on or before April 15, 2011, and must have received a preliminary certification for the project before July 1, 2011. Furthermore, either the project must receive final certification before January 1, 2013, or the applicant must demonstrate that construction of the project began prior to April 15, 2011.[4]

If an applicant can demonstrate that construction of a project began prior to April 15, 2011, final certification does not have to be received until the earlier of (1) the expiration of the preliminary certification or (2) July 1, 2014, as opposed to January 1, 2013.[5] Preliminary certifications are valid for three years, with an additional two years granted upon request.[6]

Based on BETC temporary administrative rules, effective January 13, 2012,[7] evidence of beginning construction prior to April 15, 2011, includes approved building or grading permits, as well as evidence of site-specific construction.[8] Evidence of site-specific construction may include paid invoices, time sheets, or written reports from a contractor—under penalty of perjury—detailing the work that began prior to April 15, 2011.[9]

---

1 Irina M. Antonache, J.D., LL.M, is a senior staff in the State & Local Tax Group at Moss Adams LLP in Portland, Oregon.

2 HB 3672 amended the following provisions of the Oregon Revised Statutes ("ORS"): 314.354; 469.185 through 469.225

3 *See* Or Laws 2011, ch. 474, adopting provisions in ORS 285C.540, et seq.

4 ORS 315.357.

5 ORS 315.357(3); HB 4079-B, Section 16.

6 ORS 469B.145(6).

7 *See* http://www.oregon.gov/ENERGY/CONS/BUS/docs/Rulemaking/OAR-BETC-2012.pdf.

8 Oregon Administrative Rules ("OAR") 330-090-0160(2)(a)(D).

9 OAR 330-090-0160(2)(b).

The BETC temporary administrative rules appear to provide that an applicant will not be treated as demonstrating that construction of a project began prior to April 15, 2011, unless the applicant files an application with the Oregon Department of Energy (DOE) before July 1, 2012, demonstrating the beginning of construction.[10] The DOE will issue a notification of acceptance within 60 days and include the date by which the applicant must receive a final certification to be eligible to receive the credit.[11]

For applicants who cannot prove they began construction prior to April 15, 2011, to the DOE's satisfaction, the DOE will issue a notification detailing the reasons for denial, and the applicant will have until December 31, 2012, to complete the project, file a final application, and receive a final certification.[12] It is important to note that projects with actual costs of over $50,000 must have an independent CPA certify the costs of the project and issue a report that must be submitted with the final application,[13] after which the DOE has 60 days to review the final application and issue (or deny) a final certification.[14]

Project owners should not wait until the deadline to file an application demonstrating that construction began prior to April 15, 2011. For example, if an applicant waits until June 30, 2012, to file with the DOE to prove construction began before April 15, 2011, and gets denied 60 days later, on August 30, 2012, the applicant now has approximately 60 days (or until November 1, 2012) to complete the project, have a CPA certify the costs, and file a final application to provide the DOE with 60 days for review and issuance of the final certification.

What remains unclear is whether projects that intend to use the pass-through program must also have identified a pass-through partner by the BETC sunset date or whether the DOE, the Oregon Department of Revenue (DOR), or both will provide some way to extend the deadline for securing a pass-through partner as long as the project received a final certified amount letter by the sunset date.

Renewable Energy Generation Projects

Previous Law

Prior to the adoption of HB 3672, renewable energy generation project owners that applied for and received a preliminary certification were eligible to receive an income tax credit equal to 50 percent—up to $20 million—of certified project costs, resulting in up to $10 million in BETC upon completion and final certification by the DOE. The credit was taken over five years, 10 percent each year, with an eight-year carryforward. The credit was also transferable at a discount rate set by the DOE at the time the project received a preliminary certification.[15] Purchasers may still purchase these credits today.

Current Law

HB 3672 provides a grant of up to 35 percent of project costs or $250,000 per renewable energy production system.[16] A renewable energy production system is one that uses biomass, solar, geothermal, hydroelectric, wind, landfill gas, biogas, wave, tidal, or ocean thermal energy to produce electricity.[17]

The funding for the grants is composed of contributions made by the sale of tax credits by the DOR of up to $1.5 million per year at public auction and with a reserve of at least 95 percent.[18] Contributors to the program and purchasers of the tax credits may use the credits against Oregon income tax in the year of purchase.[19] Any unused credit may be carried forward for three years.[20]

To be eligible for the grant, projects must be located in Oregon and not exceed 35 megawatts.[21] In addition, project owners must submit an application to the DOE prior to beginning construction or installation of the project.[22] However, construction must begin within 12 months of receiving the award or the grant is revoked.[23] The DOE has drafted proposed rules that outline the competitive process the DOE intends to use to administer the program and award the grants.[24]

The DOE will publish an Opportunity Announcement (OA) detailing the amount of grants available for the application period, the time period for submitting application, the application fee, and the criteria to be applied in selecting projects.[25] Applications, accompanied by the application fee, must be submitted within the time prescribed; otherwise they will not be considered.[26] The DOE will review applications for completeness before sub-

10 OAR 330-090-160(2) states: "Applicants with a preliminary certification *may* apply to the department to demonstrate that construction of the facility began before April 15, 2011." (Emphasis added.) However, OAR 330-090-160(2)(a) uses the word "must" when referring to required contents of an application, and OAR 330-090-160(2)(d) states: "Applications *must* be received by the department before July 1, 2012." (Emphasis added.)

11 OAR 330-090-0160(2)(e)(A).

12 OAR 330-090-0160(2)(e)(B).

13 OAR 330-090-0130(10)(a)(B)(ii).

14 OAR 330-090-0133(1)(b).

15 ORS 469B.148. The rates set most recently by the DOE are 67% and 73.6% of the face value of the credit. OAR 330-090-0140(1).

16 ORS 469B.256(2).

17 ORS 469B.250(3).

18 ORS 315.326(2).

19 ORS 315.326(1).

20 ORS 315.326(6).

21 ORS 469B.253.

22 ORS 469B.253.

23 ORS 469B.256(2).

24 *See* http://www.oregon.gov/ENERGY/BUSINESS/Incentives/docs/Renewable_EIP_Temp_Rule.pdf.

25 OAR 330-200-0020.

26 OAR 330-200-0030.

mitting them through the competitive review.[27] Incomplete applications or applications not accompanied by a fee will be denied.[28] Accepted applications will be reviewed and ranked based on the criteria listed in the OA.[29]

The application must include, among other things, the number of jobs created during and after construction, anticipated incentives to be received, a statement that the project will operate for at least five years, a current balance sheet and income statement, pro forma financial statements for the project (including a balance sheet at the time of the commissioning of the project), and a balance sheet, cash flow statement, and income statement for five years accompanied by a statement of assumptions used.[30] Factors taken into account during the competitive review process include the net present value of the project, the number of jobs created, the strength of the business plan, the net energy generated, the efficiency and use of the energy generated, the environmental impact, and community support.[31]

Applicants will be ranked and selected based on the amount of grant funding available.[32] Selected applicants will be notified and required to pay an additional fee within 14 days of notification before the next step, the technical review process.[33] Applicants not selected will be placed on a reserve list based on their rankings in the competitive review.[34] If selected applicants fail to pay the technical review fee within the prescribed time or are denied a grant subsequent to the technical review, applicants from the reserve list will have the opportunity to be selected based on their competitive review rankings.[35]

Applicants selected based on the technical review have 30 business days after notification by the DOE to accept and enter into a performance agreement that will contain, among other things, the amount of the grant received and milestones for which the applicant may request disbursement of grant funds.[36] Amendments to the performance agreement are allowed as long as the changes do not substantially modify the factors on which the DOE relied when granting the award.[37]

Conservation Projects

The most significant changes to conservation projects resulting from HB 3672 are a $14 million cap established per year on the amount of credits that may be certified[38] and a newly competitive application process, measured primarily on energy savings over five years.[39] Conservation projects that apply for and receive a preliminary certification remain eligible to receive a credit equal to 35 percent—up to $10 million—of certified project costs, resulting in up to $3.5 million in BETC upon completion and final certification by the DOE.[40]

The credit is taken over five years—10 percent for the first two years and 5 percent for the proceeding three years, with a five-year carryforward.[41] The credit remains transferable at a discount rate to be set by the DOE and may not be revoked once it has been transferred to a pass-through partner.[42] A project that received preliminary certification under the rules in effect prior to the adoption of HB 3672 has a pass-through rate of 72.8 percent or 73.6 percent, depending on when the project received preliminary certification.[43]

Purchasers may still purchase these credits today. The first year the credit may be used remains the year during which the DOE receives a complete and final application for certification or the year in which a pass-through partner purchases the credit.

HB 3672 also excludes from the definition of conservation project any investment for which the first-year energy savings yield a simple payback period of less than three years; recycling equipment, products, and projects; transportation projects;[44] energy recovery projects; and alternative fuel vehicles.[45] Additionally, sustainable building projects must achieve an energy-efficiency standard of at least LEED Platinum or the equivalent under a different program to be eligible for the BETC.[46]

Preliminary certifications for conservation projects issued under HB 3672 remain valid for three years with no opportunity for an additional two years as allowed under the previous program rules. The three-year limitation applies regardless of whether the project is technically complete and only waiting to identify a pass-through partner or the preliminary certification was applied for and received an amendment.[47]

27 OAR 330-200-0050.
28 OAR 330-200-0050(3); OAR 330-200-0030(2).
29 OAR 330-200-0060.
30 OAR 330-200-0030(4).
31 OAR 330-200-0060(3).
32 OAR 330-200-0060(4).
33 OAR 330-200-0060(5); OAR 330-200-0070(1).
34 OAR 330-200-0060(5).
35 OAR 330-200-0060(5); OAR 330-200-0070(1).
36 OAR 330-200-0080(4).
37 OAR 330-200-0090.
38 ORS 469B.303(1).
39 ORS 469B.273; Temporary OAR 330-210-000 through OAR 330-210-0150, effective December 23, 2011.
40 ORS 469B.282; ORS 315.331(1)(a).
41 ORS 315.331(1)(a); ORS 315.331(6). Previous program rules allowed for an eight-year carryforward.
42 469B.300(5).
43 OAR 330-090-0140(1).
44 Transportation projects have a separate and distinct BETC program.
45 ORS 469B.270(2).
46 Program rules prior to HB 3672 required a minimum efficiency standard of LEED Silver or equivalent.
47 ORS 469B.285(7).

As in the case of the process for the renewable energy project grants, the DOE will publish an OA detailing the amount of credits available for the application period, the time period for submitting an application, the application fee of $200, and the criteria to be applied in selecting projects.[48] Applications and the applicable fee must be submitted based on the timeline established in the OA, or they will automatically be denied.[49] After reviewing the applications for completeness, the DOE will review applications based on the competitive criteria and rank the applicants.[50]

The application must include, among other things, the number of jobs created during and after construction and information related to the reduction in the amount of energy consumption. Factors taken into account during the competitive review process include energy savings over five years and over the lifetime of the project, carbon reduction, diversity, strength of business plan, and job creation.[51]

Applicants will be ranked and selected based on the amount of tax credits available during a particular application round.[52] Selected applicants will be notified and required to pay an additional fee equal to 0.55% of qualifying project costs within 14 days of notification before moving to the technical review process.[53] Applicants not selected will be placed on a reserve list based on their rankings in the competitive review.[54] If selected applicants fail to pay the technical review fee within the prescribed time or are denied a preliminary certificate subsequent to the technical review, applicants from the reserve list will have the opportunity to be selected based on their competitive review rankings.[55]

Changes to the project between the receipt of the preliminary certification and final certification must be reported to and approved by the DOE, or applicants will lose their credit eligibility.[56] Requests for amendments must be accompanied by a $300 fee.[57]

Consistent with the BETC program prior to HB 3672, upon completion of the project, an applicant must submit a final application for certification.[58] A final application must be accompanied by a fee equal to 0.5% of qualifying project costs.[59] For a project with actual costs in excess of $50,000, this application must include a CPA certification, usually done in the form of an agreed-upon procedures engagement.[60] The DOE has 60 days to certify the project after submission of the final application, or it is considered rejected.[61]

Small Conservation Projects

Projects with less than $20,000 in eligible costs may participate in the competitive review process, but it is not required.[62] The DOE will issue an annual OA that will remain open for one year from the date of issuance.[63] The OA will list the requirements applicable and the amount of credits allocated to small projects.[64]

Applicants must submit an application prior to project installation or construction and meet all the requirements and criteria listed in the OA as well as comply with the final application process (except for the CPA certification, which is not required).[65]

An application that meets the applicable requirements will be issued an informational filing on a first-come, first-served basis indicating that the DOE received the filing and was complete.[66] An applicant receiving an informational filing must file a final application within 12 months of such receipt.[67] The DOE will determine the eligibility of the project prior to issuing a final certificate.[68] However, if the total amount of credit available to be allocated to small projects is awarded prior to the end of the OA period, eligible applicants will be denied a credit regardless of whether they meet the applicable requirements and criteria.[69]

Transportation Projects

Previous Law

Prior to the adoption of HB 3672, transportation facilities were treated as conservation projects and were eligible for an income tax credit equal to 35 percent—up to $10 million—of certified project costs, resulting in up to $3.5 million in BETC.[70] Qualifying transportation facilities included commuter pool vehicles, transit passes, transportation services, and efficient truck technologies.[71]

Current Law

Based on HB 3672, a transportation project is defined as a transit service provided to members of the public by

48 OAR 330-210-0040(1).
49 OAR 330-210-0030(1)(b).
50 OAR 330-210-0060.
51 OAR 330-210-0030.
52 OAR 330-210-0060(7).
53 OAR 330-210-0070(1); OAR 330-210-0040(3).
54 OAR 330-210-0060(7).
55 OAR 330-210-0060(7).
56 OAR 330-210-0090(3).
57 OAR 330-210-0040(4).
58 ORS 469B.291; OAR 330-210-0100.
59 OAR 330-210-0040(5).
60 OAR 330-210-0100(4)(g).
61 ORS 469B.291(5).
62 OAR 330-210-0045(1).
63 OAR 330-210-0045(2).
64 *Id.*
65 OAR 330-210-0045(3).
66 OAR 330-210-0045(6).
67 OAR 330-210-0045(7)
68 *Id.*
69 OAR 330-210-0045(2).
70 ORS 315.354(4)(d); 469B.142(c).
71 OAR 330-090-0110(74).

a public or nonprofit entity that receives state or federal funding for the services.[72] Additionally, a transportation project includes an alternative fuel vehicle infrastructure project defined as a facility for mixing, storing, compressing, or dispensing fuels for alternative fuel vehicles.[73]

For tax years beginning on or after January 1, 2011, alternative fuel vehicle infrastructure projects are eligible for a credit equal to 35 percent of certified costs.[74] All other qualifying transportation projects are eligible for a credit equal to 25 percent of certified costs for that tax year beginning on or after January 1, 2012, and before January 1, 2013, decreasing at a rate of 5 percent per year until the program sunset date of December 31, 2015. The DOE may not certify more than $10 million in credits for each year.[75]

Developers of eligible projects must apply for preliminary certification based on DOE requirements and criteria as well as apply for a final certification.[76] As in the case of the conservation program, the preliminary certification will remain valid for only three years regardless of whether the applicant is awaiting the identification of a pass-through partner or there has been an amendment to the preliminary certification.[77]

The credit is taken over five years, beginning with the tax year during which the DOE receives a complete final application or a pass-through partner pays for the credit.[78] In the case of a 35% credit, the amount of the credit allowed each year is 10% of certified project costs for the first two years and 5% for the following three years.[79] In the case of a less-than-35% credit, the credit allowed each year may not exceed 5% of the certified project costs.[80]

As in the case of the other programs, the DOE will publish an OA listing the requirements and criteria for qualification as well as the timeline to submit applications and the amount of credits available.[81] However, unlike the conservation and renewable energy programs, the transportation program is not competitive.[82] Complete applications will go through technical review and, assuming they meet all the criteria and requirements of the OA, will be issued a preliminary certification.[83]

The DOE must approve any changes to a project that has received preliminary certification through an amendment.[84] The project must still meet the requirements and criteria of the OA and not be substantially different than the factors upon which the DOE granted the initial preliminary certification.[85] Upon completion of the project, the applicant must file a final application for certification and, if total costs exceed $50,000, will need a CPA cost certification.[86]

Pass-through Program

Conservation and Transportation BETCs may be transferred to a pass-through partner at a rate established by the DOE by formula at the time the DOE receives a preliminary application.[87] If the DOE helps the applicant to secure a pass-through partner, the applicant must pay a fee equal to 1% of the credit amount, up to $25,000.[88] If DOE assistance is not used, the applicant must pay $100 fee for the issuance of the certificate.[89]

Conclusion

The BETC program has gone through numerous changes in the past few years. Some programs will continue and other have been permanently sunset. There are still opportunities for conservation project owners to take advantage of this fairly unique program. Whether the grant program that has replaced the BETC for renewable energy projects will be successful remains to be seen. The first auction of credits garnered little interest from potential buyers. This is likely because the DOE set the transfer price for the credit too high (a minimum of 95 cents on the dollar). It is unlikely that this grant program will be utilized in any meaningful way until the several hundred million dollars of unsold BETCs attributable to completed projects or projects under development clear the market. Although not discussed in this article, the manufacturing BETC will continue on as a viable incentive for project owners.

72 ORS 469B.320(3).
73 *Id.*
74 ORS 315.336(2)(a).
75 ORS 315.336(2).
76 ORS 469B.326.
77 ORS 469B.326(6).
78 ORS 469B.338
79 OAR 330-225-0050(2).
80 *Id.*
81 OAR 330-225-0020.
82 OAR 330-225-0080.
83 *Id.*
84 OAR 330-225-0090(2).
85 OAR 330-225-0080(5).
86 OAR 330-225-0100(4)(e).
87 ORS 469B.276; ORS 469B.323.
88 ORA 330-210-0040(7)(a); OAR 330-225-0040(6)(a).
89 ORA 330-210-0040(7)(b); OAR 330-225-0040(6)(b).

The Oregon Tax Court Examines P.L. 86-272 in the *Ann Sacks* Decision

By Scott Schiefelbein[1]

Multistate tax practitioners must always bear in mind that no matter how much effort we invest in mastering the intricacies of various state statutes, administrative rules, and case law, the broad rules of state taxation are established at the federal level. The United States Constitution, Congress, and judiciary all establish the boundaries within which the states may impose their respective tax regimes. With the recent *Ann Sacks* decision,[2] the Oregon Tax Court has examined the impact of the federal statute known as Public Law ("P.L.") 86-272 on Oregon's ability to tax.[3]

A. Brief Overview of P.L. 86-272

Congress adopted P.L. 86-272 in 1959 in response to the Supreme Court's decision in *Northwestern Cement v. Minnesota* that upheld the state's power to impose nondiscriminatory, fairly apportioned net income taxes on interstate business activities.[4] Business interests and, accordingly, Congressional leaders feared for the safety of American business and as a result P.L. 86-272 was passed in order to restrict the states' power to tax interstate business.

P.L. 86-272 is a seemingly straightforward statute that primarily prohibits states (and subdivisions) from imposing net income taxes on businesses whose only presence in the state is the solicitation of sales of tangible personal property where customers' orders are approved and shipped from outside the state.[5] The protected solicitation may be engaged in by the taxpayer or the taxpayer's representative.[6] A taxpayer is also protected if the taxpayer uses an independent contractor to solicit sales in a particular state even if the contractor maintains an office in the state and makes the actual sale (as opposed to having the sale approved out of the state).[7] In *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, the United States Supreme Court has held that "solicitation" includes those activities that are "entirely ancillary" to the solicitation of sales.[8]

The proper and precise definition of the scope of protection carved out by P.L. 86-272 (and the *Wrigley* decision) has preoccupied multistate tax practitioners from 1959 through to the present day.

B. The *Ann Sacks* Decision

The Oregon Tax Court recently examined the scope of protection offered by P.L. 86-272 in the *Ann Sacks* decision.[9] The decision focused on an affiliated group of corporations filing an Oregon consolidated corporate excise tax return where Kohler, Inc. served as the common parent. While it was clear that several of Kohler's subsidiaries had established taxable nexus with Oregon, the Tax Court examined whether Kohler's presence in Oregon was sufficient to require Kohler to include its Oregon sales and payroll numerators in the consolidated group's apportionment factor calculations (Kohler, presumably, had no property in Oregon to be included in the group's property factor calculation).[10]

Kohler acknowledged that Kohler used in-state distributors and authorized service representatives ("ASRs") to provide in-state warranty services to the engines, generators, and plumbing fixtures Kohler sold to its Oregon customers. The Tax Court focused primarily on whether these activities were sufficient to create a taxable nexus for Kohler in Oregon. Kohler also conceded that the United States Constitution did not protect Kohler from taxation

---

1 Scott M. Schiefelbein is a Senior Manager working in Deloitte's Multistate Tax Practice in Portland, Oregon. This article is written in general terms and is not intended to be a substitute for specific advice regarding tax, legal, accounting, investment planning, or other matters. While all reasonable care has been taken in the preparation of this article, Deloitte accepts no responsibility for any errors it may contain, whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person or entity that relies on it. Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Copyright © 2012 Deloitte Development LLC. All rights reserved. Scott would like to thank Tina Skidmore, Tax Partner, and Alex Meleney, Tax Principal, for their contributions and guidance during the preparation of this article.

2 *Ann Sacks Tile and Stone, Inc. v. Dep't of Revenue*, 2011 Ore. Tax LEXIS 403 (Or. T.C. Nov. 29, 2011).

3 While the statute is codified at 15 U.S.C. §§ 381-384, most practitioners refer to the statute as "Public Law 86-272" or "P.L. 86-272."

4 358 U.S. 450 (1959).

5 15 U.S.C. § 381(a).

6 *Id*.

7 15 U.S.C. § 381(c). A "representative" is not an independent contractor. 15 U.S.C. § 381(d)(2).

8 *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992).

9 The Tax Court also addressed other arguments made by the taxpayer to limit Oregon's ability to impose its corporate excise tax on the taxpayer, such as that taxpayer's business activities in Oregon did not amount to doing business in Oregon under the Oregon's statute imposing the corporate excise tax, a "unitary oversight" argument, and even an argument under Oregon's throw-back rules. These arguments were unsuccessful and are largely beyond the scope of this article.

10 Even though Kohler was included on the Oregon consolidated return, if Kohler did not have nexus with Oregon then only its apportionment factor denominators would be included in the consolidated group's apportionment calculations. For the tax years at issue, Oregon's general apportionment rules still required taxpayers to calculate Oregon apportionment using the standard three factors of property, payroll and sales, although Oregon is now only requires such taxpayers to use the sales factor.

in Oregon, so much of the decision revolved around P.L. 86-272.

The Tax Court did consider aspects of Oregon's corporate excise tax statutes. Oregon imposes its corporate excise tax on taxpayers "doing business" in Oregon.[11] Kohler first argued that it was not "doing business" in the state.[12] The Tax Court disagreed, noting that Oregon's definition of "doing business" was broadly defined as engaging in "any transaction or transactions in the course of its activities conducted within Oregon by a corporation" and that "[t]here is no question that Kohler engaged in transactions in Oregon . . . ."[13]

The Tax Court then examined whether P.L.86-272 imposed any limits on Oregon's ability to tax Kohler and concluded that the in-state warranty services provided by the distributors and ASRs easily exceeded the scope of protection offered by P.L. 86-272.[14] Citing the *Wrigley* decision, the Tax Court noted that services such as warranty work "that serve an independent business purpose apart from the solicitation of orders for sales, do not qualify for immunity under" P.L. 86-272.[15]

In rejecting Kohler's argument that the in-state warranty work did not establish nexus, the Tax Court observed that P.L. 86-272 contemplates three methods whereby a person may conduct business in Oregon: 1) by acting directly, 2) by acting through a representative, and 3) by having an independent contractor take action on the taxpayer's behalf. The Tax Court assumed that the distributors and ASRs qualified as independent contractors.

The question then turned to the consequences of the in-state activities for Kohler. The Tax Court acknowledged that the clear answer appeared to be that Kohler had established taxable nexus, but on the other hand recognized that leading authorities in the field of state taxation believe that P.L. 86-272 should not be read so broadly that any independent contractor relationship (e.g., hiring a law firm, accounting firm, or advertising firm) can create taxable nexus.[16] Unfortunately, the Court found no other guidance to answer this question:

> No Oregon constitutional or statutory provision says that activity of an independent contractor acting pursuant to a contract with an out-of-state seller of goods is insufficient to expose the out-of-state seller to Oregon's tax jurisdiction or the reach of the tax statutes that have been enacted. Nor . . . does any Oregon case justify such a conclusion. . . . Federal constitutional law presents no barrier either, as recognized by taxpayer.[17]

Accordingly, the Tax Court concluded that P.L. 86-272 "cannot protect Kohler in this case, for the reason that the activities of the distributors and ASRs extend beyond activities allowed by the statute."[18] The Tax Court suggested that almost any activity of an independent contractor beyond what was specifically protected under P.L. 86-272 might create nexus, perhaps even hiring a lawyer or an advertising firm based in Oregon. The fact that this conclusion may be lead to a very narrow scope to P.L. 86-272 does not bar this conclusion – either the Oregon Legislature or Congress can exercise their constitutional prerogatives and further limit the state's ability to tax based on the in-state activities of independent contractors. Until either legislative body acts, Kohler's current business activities will be subject to Oregon's tax regime.

Conclusion

In the wake of the *Ann Sacks* decision, out-of-state taxpayers who have independent contractors performing services on their behalf in Oregon must carefully examine those activities before concluding that the taxpayer does not have a filing obligation for Oregon's corporate excise tax. Taxpayers may still qualify for the protection offered by P.L. 86-272 in Oregon, but the Tax Court has made clear that the focus of the inquiry is the activity engaged in by any independent contractor working on the taxpayer's behalf in the context of the narrow range of protections carved out by P.L. 86-272. While the Oregon Tax Court's interpretation of P.L. 86-272's plain language may lead to seemingly unfair results, in the Tax Court's opinion, taxpayers must look to the legislature rather than the courts for relief.[19]

---

11 ORS 317.070. All ORS references in the *Ann Sacks* decision are to the 2003 version of the Oregon Revised Statutes.

12 "Doing business" was defined by ORS 317.010(4).

13 *Ann Sacks, supra*.

14 This position argued by the Oregon Department of Revenue and adopted by the Tax Court is consistent with the position in the *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States*, to which Oregon is a signatory. See *Updated Status Report Regarding State Adoption of "Phase 11" Revision of Public Law 86-272* "Statement of Information, Under Public Law 86-272," May 3, 1996

15 *Id., citing Wrigley, supra*, at 228-229.

16 The Tax Court cited arguably the leading treatise on multistate taxation: Jerome R. Hellerstein & Walter Hellerstein, 1 *State Taxation* § 6.25 (3d ed 2006) (Hellerstein & Hellerstein).

17 *Ann Sacks, supra.*

18 *Id.*

19 The taxpayer appealed the Tax Court's decision to the Oregon Supreme Court on January 13, 2012. Oregon Supreme Court S060039. The appeal is not yet on the Supreme Court's calendar. Given the Department of Revenue's victory at the Tax Court, we expect the Department to enforce the *Ann Sacks* decision pending the appeal.

Recent FBAR Developments: New FBAR Penalty Relief for Nonresident US Taxpayers (IR-2012-65) and Voluntary Disclosure Program Extended

By David C. Streicher[1]

This article covers two recent FBAR developments. This first is the IRS announcement (IR-2012-65) of a generous audit approach that eliminates FBAR penalties for many nonresident US citizens who did not file US income tax returns or FBAR forms. The second is the Treasury's new offshore voluntary disclosure program.

Not discussed in this article is the Foreign Account Tax Compliance Act ("FATCA"), as codified at IRC §§ 1471 - 1474 and 6038D. FATCA took effect in 2012 and requires US taxpayers who have an interest in certain specified foreign financial assets with an aggregate value exceeding thresholds beginning at $50,000 to report those assets to the IRS on Form 8938, which is submitted along with the taxpayer's income tax return. (See IRS Notice 2011-55)

Full FBAR Penalty Relief Under IR-2012-65

There are untold numbers of US citizens who have lived outside the US (primarily in Canada) for many years. Typically, they have not filed US income tax returns and owe no US tax (because of the US foreign tax credit). Nor have they filed Treasury Department Forms TDF 90-22.1 to report their "offshore" accounts. As a result, absent reasonable cause, they might owe FBAR penalties of $10,000 per account per year, or even larger penalties if the violation was willful.

Fortunately, many of these non-filers will qualify for relief under Internal Release 2012-65, as issued June 26, 2012, which clarifies that they will owe no FBAR penalties if they comply with the following requirements and satisfy the following criteria:

- **File Delinquent Income Tax and FBAR Forms.** Taxpayers first must submit delinquent IRS Forms 1040NR (along with full payment of income taxes and interest due) for the prior three years, and delinquent Forms 90-22.1 for the prior six years. (Only the past six years of Forms 90-22.1 are necessary because the statute of limitations for unfiled FBAR forms is six years.)
- **Delinquent Tax Liability Does Not Exceed $1,500 Per Year.** For "low compliance risk" submissions, the IRS will perform an expedited review and will not assess penalties; "low compliance risk" generally means submissions by those taxpayers who have simple returns with less than $1,500 in US tax due for each delinquent year. For submissions with a higher compliance risk, the IRS will perform a more detailed review and might require additional year returns. Higher compliance risk factors include (i) a greater amount of income or assets of the taxpayer, (ii) indications of sophisticated tax planning or tax avoidance, (iii) material economic activity in the US, (iv) any history of noncompliance with US tax law, or (v) certain types and amounts of US source income.
- **Reasonable Cause Explanation.** IR-2012-65 goes on to say that a taxpayer having reasonable cause for delinquent Form 90-22.1 filings should submit a dated statement signed under penalty of perjury that explains why there is reasonable cause. Query: Why does reasonable cause matter? IR-2012-65 states that the IRS will not assert penalties against taxpayers having "low compliance risk," without any mention of reasonable cause. Presumably, then, such reasonable cause relief is intended for those submissions not qualifying as "low compliance risk." Perhaps another unstated intent is to deny IR-2012-65 relief to taxpayers who intentionally ignored the requirement to file Forms TDF 90-22.1.
- **Relief for Delinquent Form 8891.** IR-2012-65 also provides relief for late filing of the election on Form 8891 to defer income on offshore retirement plans, such as a Canadian RRSP or RRIF.
- **No Relief to US Residents.** IR-2012-65 applies only to nonresidents. Thus, the relief is inapplicable to US persons (i.e., citizens and green card holders) living in the US, who are relegated to seeking relief by demonstrating reasonable cause or enrolling in the 2012 Offshore Voluntary Disclosure Program (see below).
- **Summary.** The key significance of IR-2012-65 is that full FBAR penalty relief is available to many (or most) nonresident US citizens who were delinquent on filing both US income tax returns and Forms TDF 90-22.1 and who owe little or no income tax. Prior IRS guidance (such as FS-2011-13) hinted at this result, but was not definitive.

2012 Offshore Voluntary Disclosure Program

On January 9, 2012, the IRS announced a new Offshore Voluntary Disclosure Program ("2012 OVDP"), which effectively extends (with several changes) the 2011 program that ended on September 9, 2011. For a thorough analysis of the 2011 Offshore Voluntary Disclosure Initiative, see Eller, "The IRS Offshore Voluntary Disclosure Initiative: The IRS Serves Up an Additional (Final?) Round of FBAR Relief" (OSB Tax Section Newsletter, Spring Edition 2011).

As mentioned above, IR-2012-65 provides FBAR penalty relief to many US citizens and green card holders living outside the US (either "low compliance risk" relief or reasonable cause relief). Thus, the 2012 OVDP seems

1 David Streicher is an attorney at Black Helterline LLP in Portland, Oregon.

pointed at resident US citizens or green card holders who failed to file Forms TDF 90-22.1 and also failed to pay the tax on the related offshore income.

The 2012 OVDP allows taxpayers who failed to file Forms TDF 90-22.1 (to report their offshore accounts) to do so with reduced penalty exposure. The "relief" afforded by the 2012 OVDP is still painful: the standard penalty is 27.5% of the highest aggregate account balance during the last eight years. (However, some may find this less expensive than the statutory penalty under 31 USC § 5321(a)(3) of $10,000 per year per unreported account.) Lower penalties of 12.5% and 5% remain intact for taxpayers meeting stringent criteria. The 2012 OVDP is not available if the taxpayer already has been contacted by the IRS.

The key changes from the 2011 OVDP are the following:

- **No Deadlines**. The 2012 OVDP ostensibly imposes no deadline on filing delinquent Forms TDF 90-22.1, and the program currently has no termination date. However, the IRS indicates that the program (including eligibility and penalty rates) may change or end at any time.
- **New List of Frequently Asked Questions.** On June 26, 2012, the IRS posted updated 2012 OVDP frequently asked questions and answers, which are sometimes referred to as "FAQs."
- **Increased Penalty Rate.** The penalty rate was increased from 25% to 27.5%.
- **2012 OVDP Unnecessary if Taxpayers Made All Filings Except FBARs.** Taxpayers need not use the 2012 OVDP if they reported all income on overseas accounts and paid all taxes in prior years. Instead, they merely need to file the delinquent Forms TDF 90-22.1 with the Department of Treasury along with an explanation of why the Forms TDF 90-22.1 were filed late. See FAQ 17. Query: Is full penalty relief available under FAQ 17 if the prior year income tax returns were filed late? Or if filed all at once along with the delinquent Forms TDF 90-22.1? If yes, then FAQ 17 treats US taxpayers living in the US nearly the same as IR-2012-65 treats US taxpayers living outside the US.
- **No De Minimis Exception.** As in the 2011 OVDP, there is no de minimis exception to the 27.5% penalty. In other words, if there is any unreported income on any offshore account, the relief described in FAQ 17 will not apply. See FAQ 33.

Mid-Valley Tax Forum Luncheon Series

October 16, 2012
Jim Griggs and David Myers, Domicile: Multistate Issues

December 11, 2012
Jason Beyrouty, Health Care Law

2013 Oregon State Bar Taxation Section Luncheon Series

January 17, 2013
Walter W. Miller, Health Care Reform Act: Who's Paying the Bill?

February 21, 2013
Jeffrey M. Wong, The Nuts and Bolts of the Federal Audit Controversy Process

March 14, 2013
Michael Millender and Mark LeRoux, A Dash of SALT: Planning Opportunities and RecentDevelopments in State and Local Taxation

April 18, 2013
Ryan R. Nisle, Helping Start-Ups Navigate Sections 83 and 409A

May 16, 2013
Larry J. Brant, Recent Developments in the World of S Corporations

June 20, 2013
Cynthia Cumfer, What to Know About Exempt Organizations

September 18, 2013
Robert T. Manicke, Oregon Legislative Update

October 17, 2013
Judge Henry C. Breithaupt, Oregon Tax Court Update

November 21, 2013
Neil D. Kimmelfield, Partnership Tax Allocations: Basic Principles and Current Topics

December 19, 2013
Mark Alan Prater, Update From the Capital

Portland Tax Forum Breakfast Series

October 11, 2012
Yoram Keinan, International Tax: FBAR & FACTA

November 8, 2012
Gil Rothenberg, Tax Litigation: The Issues the IRS Is Litigating

January 24, 2013
Jack Bogdanski, Valuations: What's New and Important in Tax Valuations

February 14, 2013
Jerry August, Partnership Tax: Partnership Formations

June 13, 2013
Stephen Looney, S Corps

Taxation Section Mentor Program End of Year Celebration

Congratulations to Dan Eller – Our 2012 Mentor of the Year

Please join your tax section colleagues, including participants in the 2012 mentor program, for the End of Year Celebration, where we will present Dan Eller our 2012 Mentor of the Year Award.

WHEN: 5:30 – 7:00 p.m. – Wednesday, November 14, 2012

WHERE: Paddy's Bar and Grill, 65 SW Yamhill Street, Portland, Oregon

COST: Free. Light appetizers will be provided. No host bar.

Dan Eller was selected as our 2012 mentor of the year in recognition of his generosity and dedication to mentoring. He is known for finding time to make personal connections with mentees, understanding their needs, and helping them achieve their professional goals. Dan offers meaningful advice, arranges valuable introductions, stays in contact, and leads by example. He participates in several mentor programs, including those through the Taxation Section, Lewis and Clark Law School and Portland State University. Eller serves on the Taxation Section Executive Committee and is a shareholder at Schwabe, Williamson & Wyatt PC, where he focuses on tax and business law, advising clients on both transactional and controversy matters.

If you are interested in participating in the 2013 Taxation Section Mentor Program, please complete the mentor program questionnaire (at www.osbartax.com/mentor-program) and email it to NTLCMentorProgram@gmail.com on or before December 7, 2012.