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A Washington National Tax Services (WNTS) Publication

January 27, 2012

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Oregon Tax Court includes stock sale gains constituting business income in sales factor denominator

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The Oregon Tax Court recently held that gains from the sale of the stock of a subsidiary constituting business income subject to apportionment must be included in the Oregon sales factor denominator. [*Oracle Corporation v. Dept. of Revenue*, Oregon Tax Court, No. TC-MD 070762C, 1/19/12]

Background

Oracle Corporation ("Oracle"), a Delaware corporation with its principle place of business in California, develops database and application business software. Through its subsidiary Oracle Japan Holding, Inc., Oracle held stock in Oracle Japan. During tax years ending May 31, 1999, and May 31, 2000, Oracle sold shares of Oracle Japan common stock. Oracle's gains from these sales were $24 million and $6.4 billion, respectively. On the grounds that the gains had no connection with Oracle's business activity in Oregon, Oracle excluded the gains in computing its Oregon taxable income.

During tax years ending May 31, 2000, and May 31, 2001, Oracle sold shares of Liberate common stock, another of its subsidiaries. Oracle's gains from these sales were approximately $441 million and $31 million, respectively. On the grounds that the sales were unrelated to Oracle's Oregon business activities and the gains were not part of the business of Oracle's unitary group doing business in Oregon, Oracle excluded those gains in computing its Oregon taxable income.

The Department of Revenue adjusted Oracle's Oregon excise tax returns to include the gains on the sales of Oracle Japan and Liberate stock and issued notices of assessment for the tax years at issue for approximately $5.17 million, plus $2.6 million in interest.

Gain from the sales of stock must be included in Oregon sales factor denominator

With respect to the sales of Oracle Japan stock, Oracle chose not to contest the Department's characterization of the gain as business income. Therefore, the sole issue for the Court to decide was whether the gain was includible in the denominator of the sales factor under Oregon's statutory apportionment formula.

The Department argued that the gains from the sales of Oracle Japan stock should be excluded from the sales factor denominator because they were from sales made outside the regular course of Oracle's business. Oracle responded that the gains should be included in its sales factor denominator under ORS 314.665(6)(b). Under the statute, "sales" for purposes of the sales factor includes "net gain from the sale... of intangible assets not derived from the primary business activity of the taxpayer but included in the taxpayer's business income." While the gain was not derived from its primary business activity, Oracle argued, the gain was still included in business income (as agreed to by the parties) and thus satisfied the statutory test for inclusion. Further, Oracle argued that the Department may not determine that the acquisition, use, and disposition of the Oracle Japan stock "was an integral part of Oracle's regular trade or business" for purposes of including the sales proceeds in apportionable business income, and then "turn around and claim that it is not" for purposes of determining whether the sales proceeds should be included in the sales factor denominator.

The Court agreed with Oracle and held that the gains constituted business income includible in the sales factor denominator. The statutory requirement for inclusion of the gain in the denominator "is that the gain not be derived from the taxpayer's '*primary* business activity,'" the court noted. Further, to the extent the Department's regulation (OAR 150-314.665(1)-(A)(5)) would exclude such gain otherwise includible under the statute, the rule is invalid.

Finding of business income

With respect to the gains on the sales of Liberate stock, Oracle argued that they were not includible in its Oregon taxable income because at the time of the sale Oracle and Liberate were no longer unitary, and Oracle did not hold the Liberate stock as part of its unitary business.

The Court disagreed, finding evidence of a unitary relationship between the two entities at the time of the stock sale. The Court relied on indicia of unity including Oracle's more than 50% ownership of Liberate at the time of the sales and several related party transactions that took place during the tax years at issue. Further, for the reasons laid out above relating to the sales of Oracle Japan stock, the Court held that the gains from the sales of Liberate stock constituted business income included in the denominator of the sales factor.

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