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A Washington National Tax Services (WNTS)
Publication

September 9, 2011

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Oregon Tax Court: Timing of severing unitary relationship controls assignment of NOLs between members

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In a case of first impression, the Oregon Tax Court held that net operating losses incurred by a unitary group member that departs the group mid-year may be taken into account by the remaining group members, but only to the extent those losses were incurred on or before the departure date. [[US West, Inc., et. al., v. Department of Revenue, Oregon Tax Court TC 4896; TC 4897, Aug. 20, 2011](#)]

Facts

US West, Inc. and Qwest Dex Holdings, Inc. (collectively, USW) are the parents of two different unitary groups, each of which file separate Oregon consolidated tax returns. The two unitary groups, together with their common parent, Media One (MO), are members of an affiliated group that files a federal consolidated tax return.

On June 12, 1998, MO distributed all of its USW's shares to its shareholders, thereby departing from USW's federal consolidated group. For federal tax purposes for the tax year ending December 31, 1998, MO filed a consolidated return for the full year, reflecting a single 12-month period and including in that return tax items of USW only for the period January 1, 1998 through June 12, 1998. USW was required to divide its 1998 tax year into two filing periods for federal and Oregon purposes - first for the period January 1, 1998 to and including June 12, 1998 (pre-spin) and second



for the period June 13, 1998 through December 31, 1998 (post-spin). MO generated significant tax losses throughout the year while USW generated taxable income in both pre-spin and post-spin periods.

On USW's originally filed Oregon consolidated tax return for the post-spin tax period ending December 31, 1998 USW deducted NOL carryforwards from the pre-spin period computed by combining USW's pre-spin year income with MO's pre-spin year losses. In an amended filing, USW recomputed available NOL carryforwards arising from the pre-spin period by increasing them to include the effect of MO's full-year loss, including the loss for the post-spin year.

Taxpayer cannot take into account other member's tax items after severance of unitary relationship

The Department of Revenue argued, and the Oregon Tax court agreed, "that the loss of MO that may be taken into account in computing the loss carryover for USW is only the loss of MO for the period from January 1, 1998, to and through June 12, 1998." The court considered a "closing of the books" method for determining items of income and loss for the pre-spin period, but ultimately concluded that the time ratio approach proposed by the Department was a reasonable method by which to compute the NOL carryforward available to USW.

The Department applied a time-based allocation method, determining the amount of the loss assigned to USW by first multiplying MO's full 1998 tax year loss by a fraction, the numerator of which is the number of days in the pre-spin period and the denominator of which is 365. USW's pre-spin period income was subtracted from this amount to determine the net operating loss allocable to the pre-spin year. The amount of the pre-spin net operating loss was then subject to apportionment to determine how much of the loss was assigned to USW as carryover for use in the post-spin and subsequent years.

In support of finding that the time-based allocation method is reasonable, the Court noted that the same method is used to calculate the results of individual members filing a consolidated tax return and "[t]he direction of the legislature is to follow the federal consolidated return regulations that touch on separate company determinations."

PwC Observes

"This case may have implications for many other situations involving the departure of a federal consolidated group member from the Oregon unitary group," observes Ken Lee, PwC Director in San Jose, California. "For example, the Court suggests that both a 'closing of the books' method as well as a time-based ratable allocation method could be 'reasonable.'"

"The Court highlighted the difficulties taxpayers face in properly applying consolidated return regulations in the context of unitary combined filings. Notably, the Court applied mechanics derived from federal consolidated return regulations for purposes of the Oregon unitary return in certain respects, but held them to be inoperative in other unitary contexts. For instance, the Court specifically precluded application of the federal 'contribution to pool' method of assigning operating losses

prescribed under Treas. Reg. § 1.1502-21T(b)(2). The application of that federal method 'would fundamentally depart from the unitary taxation concept that group loss, or income, is to be shared among group members based on apportionment percentages.' However, the time-based allocation method used in federal consolidation was nonetheless determined to be a reasonable method to use under Oregon tax law."

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