

## Oregon - Bankruptcy Court, no nexus due to intangible presence

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### ***In brief***

A corporate parent filed an Oregon consolidated return with its subsidiaries. Following the sale of the subsidiaries, the Department of Revenue sought to impose tax owed by the subsidiaries on the out-of-state parent corporation. The bankruptcy court found that the imposition of tax violated the Due Process Clause because the parent had no employees, tangible property, or revenues associated with Oregon and because the parent did not receive benefits from in-state intangible property used by its subsidiaries. The court also held that finding the parent liable for the tax of its subsidiaries merely because it allowed the free use of its trademarks and received a dividend would deeply burden interstate commerce in violation of the Commerce Clause. [*In re Washington Mutual*, No. 08-12229 MFW, 2012 WL 6623678, Bkrcty. D. Del. (12/19/12)]

### ***In detail***

#### ***Facts and procedural history***

During tax years 1999 through 2005, Washington Mutual, Inc. (WMI) was a bank holding company that owned Washington Mutual Bank and some of its subsidiaries (the WMB Entities), which conducted banking-related operations in Oregon. WMI owned certain intangible property (including trademarks, service marks, and domain names) that was used by the WMB Entities in Oregon without payment of a royalty. During this period, WMI and the WMB Entities filed as members of a consolidated return for Oregon tax purposes.

In 2008, following a bank run resulting from a downgrade in WMI and WMB's credit ratings and the global debt crisis, all of WMB's assets were sold to a third party and WMI filed for chapter 11 bankruptcy.

Following an audit of the 2002 to 2006 tax years, and the issuance of a notice of assessment to WMI, the Oregon Department of Revenue filed a proof of claim in WMI's chapter 11 case seeking payment of \$29 million for corporate excise taxes, interest, and penalties owed by the WMB Entities relating to the audit period.

WMI argued that: (1) it was not jointly and severally liable for the excise tax obligations of the WMB Entities even though it

filed an Oregon consolidated return with the WMB Entities; and (2) the tax was unconstitutional in violation of both the Due Process and Commerce Clauses of the US Constitution.

#### ***Joint and severable liability***

The Department asserted that WMI was liable for Oregon tax owed by its subsidiaries because, as the parent holding company of its unitary business, it filed consolidated corporate tax returns on behalf of itself and its subsidiaries. According to the Department, by filing the Oregon return in its name, WMI "admitted that it was doing business in Oregon and was liable for the excise tax." The Department sought to impose

joint and several liability upon WMI because it was included in the consolidated return, pursuant to Ore. Stat. sec. 317.710(2) ("the corporation's tax liability shall be joint and several with any other corporation that is included in a consolidated state return . . .").

The court did not address the merits of the Department's assertion of joint and several liability. Instead, the court moved directly to considering whether the imposition of tax on WMI was constitutionally permissible.

***Due Process violated - no minimal connections and no benefit received from in-state activities***

The court recognized that Due Process Clause requirements are not satisfied unless: (1) WMI had minimum contacts with Oregon; and (2) the income the Department sought to tax relates to a benefit received from Oregon. The court found that neither existed in this case, and therefore held that the tax on WMI violated the Due Process clause of the US constitution.

The court found that no minimum contacts existed between WMI and Oregon because WMI had no employees or property in Oregon, no business activity within or directed towards Oregon, and received no revenue from Oregon sources.

The Department asserted that WMI received benefits from in-state activities in the form of increased goodwill and cash dividends because WMI's trademarks were 'used' in the state. The court disagreed with the Department, holding that WMI received no benefit from Oregon because WMI did not receive any

income from the WMB Entities' use of the intellectual property.

***Commerce Clause violated - no substantial nexus with Oregon***

The court recognized that WMI must have a substantial nexus with Oregon for the imposition of the state's tax to survive a Commerce Clause challenge. The court examined the different methods courts have used to determine whether a 'substantial nexus' exists, and ultimately found that WMI's activities did not amount to a substantial nexus with Oregon under the US Supreme Court's Commerce Clause standard articulated in *Complete Auto Transit v. Brady*.

- **Physical presence.** The court interpreted *Quill v. North Dakota* as establishing a bright-line physical presence test only for state sales tax. Accordingly, the Oregon excise tax does not violate the Commerce Clause simply due to WMI's lack of a physical presence in the state.
- **Economic presence.** The court acknowledged that the economic presence test has not been endorsed by the US Supreme court. As a result, state court economic presence decisions are not determinative of whether the Commerce Clause's 'substantial nexus' requirement is satisfied. However, WMI's economic presence is a factor to be considered in determining whether WMI possessed a substantial nexus with Oregon.

- **Complete Auto's substantial nexus requirement.** The court found that WMI did not have a substantial nexus with Oregon as required by the Commerce Clause because WMI did not realize a quantifiable benefit from the use of its intangible property in the state. WMI did not receive any income from the WMB Entities' use of WMI's intellectual property.

Furthermore, the court found it important that the Department was seeking to impose an excise tax on WMI for its subsidiaries' operations in Oregon. The court determined that finding a parent holding company liable for the corporate excise tax of its subsidiaries merely because it allowed the free use of its trademarks and received a dividend would deeply burden interstate commerce.

***The takeaway***

While this decision comes from a federal bankruptcy court, it continues the recent trend of courts finding that state tax statutes violate both the Due Process and Commerce Clause. For two similar state court decisions, please read our summaries regarding West Virginia's [ConAgra](#) decision and Oklahoma's [Scioto](#) decision.

*Washington Mutual* also establishes a federal court's acknowledgment that, under US Supreme Court standards for Commerce Clause requirements, state-created economic presence concepts are not determinative and that the presence of intangibles alone does not constitute substantial nexus under the Commerce Clause.

## ***Let's talk***

If you have any questions about the *Washington Mutual* decision, please contact:

### ***State and local tax services***

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