

Oregon - Telecommunication company's gain from sale of assets is apportionable business income

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In brief

In *Crystal Communications, Inc. v. Department of Revenue*, decided on March 7, 2013, the Oregon Supreme Court held that gain realized from the sale of a telecommunication company's assets was apportionable business income [[Crystal Communications, Inc. v. Department of Revenue](#), Ore. Supreme Ct., TC 4769; SC S059271, 3/7/13]. Based upon essentially the same facts, the Court affirmed this holding in *CenturyTel, Inc. v. Department of Revenue*, decided the same day [[CenturyTel, Inc. v. Department of Revenue](#), Ore. Supreme Ct., TC 4826; SC S059502, 3/7/13]. While involving provisions specific to telecommunication taxpayers, these decisions may provide support for other Oregon taxpayers that revenue from the sale of assets in liquidation qualifies as business income.

In detail

Facts and procedural history

During the 1999 and 2000 tax years, Crystal Communications (Crystal) was domiciled in Florida and organized as an S corporation with shareholders residing outside of Oregon. Crystal held a license from the Federal Communications Commission (the FCC license) to operate wireless telecommunication services in an Oregon designated service area. In June 1999, Crystal sold its assets, including the FCC license, to AT&T for approximately \$47.8 million and subsequently liquidated. On its 2000 Oregon excise tax return, Crystal classified the

gain of the FCC license as nonbusiness income allocable to Florida.

On audit, the Department reclassified the gain on the sale of the FCC license as business income. Crystal appealed the reclassification to the Tax Court, which upheld the treatment of the gain as apportionable business income ([click here](#) for our summary of the Tax Court decision). Crystal further appealed to the Oregon Supreme Court.

Business income for public utilities

Oregon law contains two statutory provisions for apportioning income earned by multistate business: (1) one

applicable to financial institutions and public utilities and (2) one generally applicable to all other businesses (the codification of the Uniform Division of Income for Tax Purposes Act, or UDITPA). As a public utility Crystal was governed by ORS 314.280(1), which provides that the determination of net income is based upon a taxpayer's business activity within the state. The statute does not specifically define 'business income' but grants the Department authority to adopt rules and regulations implementing this provision.

Under such authority, the Department promulgated OAR 150-314.280-(A)(2), which

provides that the provisions of UDITPA, as codified in Oregon law, apply in determining the apportionable business income of public utilities. Further, OAR 150-314.280-(B), provides that the definition of business income contained in the provisions of UDITPA and related rules are incorporated into Oregon law for purposes of determining the apportionable business income of public utilities.

Under UDITPA, 'business income' means the income arising from transactions and activity in the regular course of the taxpayer's trade or business (transactional test) and includes income from tangible and intangible property if the acquisition, management, use or rental, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations (functional test). In this case, there was no dispute that the FCC gain qualified as business income under the transactional test. As a result, any analysis under the UDITPA rule was made under the functional test.

Finally, the Department promulgated the 'Business Income Rule,' further defining 'business income' for UDITPA purposes. Under that rule, 'business income' includes gain or loss from the sale, exchange or other disposition of real or intangible personal property if the property while owned by the taxpayer was used in the taxpayer's trade or business.

Crystal's argument - conflicting definitions of business income

As a result of the Department's regulation OAR 150-314.280-(B) discussed above, there were two potentially conflicting definitions of 'business income' that the court sought to reconcile:

- UDITPA's functional test, which generally provides that the acquisition, management, **and** disposition of an asset must be integral to a taxpayer's business for its sale to constitute business income (under which the parties disagreed whether the FCC gain would qualify as business income), and
- Oregon's Business Income Rule, which includes in business income the sale of property "used in the taxpayer's trade or business" (which the parties agreed was broad enough to cover the FCC gain as business income).

Crystal generally argued that the definition of business income found in the Business Income Rule reached more broadly than the statutory definition of that term in UDITPA. While it conceded that under the Business Income Rule the gain would be subject to apportionment, Crystal argued that the Business Income Rule was inconsistent with the UDITPA definition of business income, and was therefore inapplicable to the extent of the inconsistency.

Specifically, Crystal argued that the gain did not qualify under the functional test because the acquisition, management, **and** the disposition of the FCC license did not constitute integral parts of its regular trade or business. Further, Crystal read a liquidation exception into the law because when a disposition of property occurs as part of a liquidation of a business, the disposition is not an integral part of the taxpayer's regular business operations.

Power to dispose of an asset that was an integral part of regular operations satisfies the functional test of business income

The Department argued that the promulgation of its two regulatory definitions of 'business income' were consistent under the interpretation of UDITPA's functional test utilized by the California Supreme Court in *Hoechst Celanese Corp. v. Franchise Tax Board*, 25 Cal.4th 508, 22 P3d 324, cert. den., 534 US 1040 (2001). In *Hoechst*, the California Supreme Court found that the functional test did not require that the disposition of property had to be a part of a taxpayer's business – only that a taxpayer must have the *power* within its regular business to dispose of property.

In this case, the Court agreed with the Department and held that the decision in *Hoechst* is a plausible interpretation of the functional test. Further, the Court found that this interpretation reasonably gave effect to both definitions of business income included in OAR 150-314.280-(B). Consequently, the Court held that the definitions of business income contained in OAR 150-314.280-(B) (which referenced UDITPA and the Business Income Rule) were broad enough to reach the gain from the sale of Crystal's FCC license.

The Court stressed that its decision did not reach a determination as to whether business income under UDITPA includes gain realized from the sale of an asset during the course of liquidation. The Court did not view this case as one rising under UDITPA. Rather, the question before the Court was "whether, in a case arising under ORS 314.280 [involving public utilities], the department reasonably interpreted the two definitions of 'business income' in OAR 150-314.280-(B) [UDITPA and the

Business Income Rule] in a way that gives effect to both." Ultimately, however, the Court essentially concluded that the UDITPA definition of business income was not inconsistent with ORS 314.280 and that the wording of ORS 314.280 did not preclude the apportionment of gain from the sale of assets in the course of liquidation.

Court reaches same conclusion in another business income case

In *Centurytel*, the Court was met with essentially the same issue presented by *Crystal Communications*. In 2002, Centurytel, Inc., a public utility, sold

its assets related to wireless services and reported the gain from the sale as nonbusiness income allocable to its state of commercial domicile. However, for the same reasoning set forth in *Crystal Communications*, the Court held that CenturyTel's gain was business income subject to apportionment.

The takeaway

Even though the Court notes that its decision is based on ORS 314.280 and not UDITPA, the Court's decision ultimately harmonizes any differences between the definitions of business income that apply to those respective

statutes. Following *Hoechst*'s interpretation of the functional test, the Oregon Supreme Court concluded that there is no 'liquidation exception' to the functional test for UDITPA business income and that such conclusion is consistent with Oregon's Business Income Rule. Accordingly, for Oregon income and excise tax purposes, *Crystal Communications* would appear to support a finding that the gain from the sale of assets in liquidation may qualify as business income subject to apportionment for taxpayers other than public utilities.

Let's talk

If you have any questions about *Crystal Communications*, *CenturyTel, Inc.*, or the business/nonbusiness income issue in Oregon, please contact:

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