

Oregon – Gross receipts from one-time sale of intangible assets excluded from sales factor

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In brief

A manufacturer and retailer of electronics equipment was not required to include in its Oregon sales factor gross receipts from the sale of intangible assets relating to the sale of its printer division. The Oregon Supreme Court held that the taxpayer was not engaged in the business of selling business divisions, and therefore gross receipts from related intangible asset sales (e.g., goodwill) were not included in the taxpayer's Oregon sales factor. The decision appears to broaden the Oregon sales factor's intangible asset sale exclusion. Oregon taxpayers that included sales of non-liquid intangible assets in their Oregon sales factor should consider whether this decision impacts their prior Oregon tax return filings. [*Tektronix, Inc. & Subs. v. Department of Revenue*, Or. Sup. Ct. No. S060912 (12/12/13)]

In detail

Facts

During the 1999 tax year, Tektronix was engaged in the business of developing and selling test, measurement, and monitoring equipment. In 1999, Tektronix sold its printer division for approximately \$925 million. Approximately \$590 million represented gross proceeds from the sale of intangible assets, including goodwill. Tektronix did not include the \$590 million in its 1999 Oregon sales factor.

Pursuant to a 2005 federal audit, the IRS reduced Tektronix's 2002 net capital loss (which was carried back to its 1999 tax year). Accordingly,

Tektronix amended its federal and Oregon 1999 corporate income tax returns reflecting the reduced net capital loss carryback.

The Department generally must file a notice of deficiency within three years of the date a tax return is filed. However, in 2005 the Department commenced a review of Tektronix's 1999 Oregon return taking the position that the IRS's 2005 adjustment reopened the entirety of Tektronix's 1999 Oregon tax return for audit. Pursuant to the audit, the Department concluded that Tektronix should have included the gross proceeds from the sale of the printer division's intangible

assets, \$590 million, in the numerator and denominator of its Oregon sales factor.

Tektronix filed a complaint in tax court arguing that: (1) Oregon's three year statute of limitations barred the Department from assessing any additional tax for the 1999 tax year and (2) that the \$590 million should not be included in the sales factor. On a motion for summary judgment, the tax court ruled in favor of Tektronix. The Department appealed to the Oregon Supreme Court.

Oregon's intangible assets exclusion rule

Both parties agreed that the \$590 million at issue

constituted business income. Accordingly, the Oregon Supreme Court acknowledged that the only issue on appeal related to the apportionment of business income under the sales factor.

The tax court relied on a definition of ‘sales,’ for purposes of the sales apportionment factor, that excludes gross receipts from the sales factor to the extent the following two elements are satisfied: (1) receipts must derive from the sale of *intangible assets*; and (2) such receipts are *not* “derived from the taxpayer’s primary business activity.” The tax court referred to this as the “intangible assets exclusion rule.”

‘Intangible assets’ are not limited to liquid assets

The tax court held that the “intangible assets exclusion rule” refers only to ‘liquid assets,’ e.g., those assets held to provide an immediate source of funds. The tax court viewed such assets as those serving a ‘treasury’ function whereby a taxpayer ‘parks’ cash in short-term securities until the cash is needed in the ordinary course of business. Because Tektronix’s business division sale did not derive receipts from ‘liquid assets,’ the tax court concluded that the intangible asset exclusion rule had no application to the \$590 million (however, the tax court ruled in favor of the taxpayer on other grounds).

The Oregon Supreme Court disagreed with the tax court and ruled that ‘intangible asset’ broadly means any nonphysical asset or resource that can be amortized or converted to cash, including goodwill. Having satisfied the ‘intangible asset’ element of the intangible assets exclusion rule, the ‘primary business activity’ element was addressed next.

Receipts from the sale of intangible assets were not derived from Tektronix’s ‘primary business activity’

The Department argued that the \$590 million derived from Tektronix’s primary business activity because Tektronix developed the goodwill in the operation of its business division and the printing division was central to Tektronix’s primary business of manufacturing and distributing electronics products.

The Oregon Supreme Court disagreed, recognizing that Tektronix was in the business of manufacturing and selling electronics equipment *not the selling of business divisions*. The sale at issue here did not involve the sale of electronics equipment, but rather the sale of an entire division of Tektronix’s business. There was no evidence that Tektronix’s primary business was engaging in the sale of its divisions.

Accordingly, the Oregon Supreme Court held that the \$590 million of receipts must be excluded from Tektronix’s sales factor because “such receipts resulted from the sale of intangible assets that were not derived from taxpayer’s primary business activity.”

‘Net gain’ sales definition not resolved by the court

Another definition of ‘sales’ includes the *net gain* from the sale of intangible assets not derived from the primary business activity of a taxpayer, but included in a taxpayer’s business income.

The Department’s original explanation of its 1999 tax year adjustments included reliance on Oregon’s inclusion of *net gains* from the sale of intangible assets. However, by the time the case reached the tax court, the Department shifted its

position and relied exclusively on the position that *gross receipts* from the intangible sales were included in the sales factor.

Statute of limitations issue not resolved by the court

Because the Oregon Supreme Court concluded that the \$590 million should not be included in Tektronix’s sales factor, it determined that it was not required to resolve the statute of limitations issue.

Takeaway

The Oregon Supreme Court determined that it was not required to resolve the statute of limitations issue since it agreed with the taxpayer’s substantive position. Unfortunately, Oregon taxpayers will continue to operate with uncertainty regarding whether the Department may reopen previously closed tax years as a result of an RAR adjustment and adjust Oregon income for reasons unrelated to the federal audit.

In addition, the Oregon Supreme Court’s decision substantially broadens the scope of the exclusion of intangible assets from the sales factor pursuant to ORS 314.655(6)(a). Prior to this decision, the tax court had determined this provision was limited to ‘liquid assets,’ relying, in part, on the model regulations adopted by the Multistate Tax Commission, which limited UDITPA to those assets. Finding the model regulations were not applicable to its decision, the Oregon Supreme Court’s conclusion relied upon the general definition of ‘intangible assets.’ This is a significant shift from the conclusion reached by the tax court. Oregon taxpayers that included sales of non-liquid intangible assets in their Oregon sales factor should consider whether this decision impacts their prior tax return filings

Let's talk

If you have any questions regarding the *Tektronix* decision, please contact:

State and Local Tax Services

Tina Skidmore
Partner, *Seattle*
+1 (206) 398-3112
tina.skidmore@us.pwc.com

Nikki Dobay
Manager, *Portland*
+1 (971) 544-4467
nikki.e.dobay@us.pwc.com

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