

SALT Alert! 2015-24: Oregon Tax Court Holds Multistate Tax Compact Election not Available in Computing Oregon Corporate Excise Tax Liability

On September 9, 2015, the Oregon Tax Court held that a taxpayer could not elect to utilize the Multistate Tax Compact's allocation and apportionment provisions in computing its Oregon corporate excise tax for the tax years at issue (2005-2007). [Health Net, Inc. v. Oregon Dep't of Revenue \(Ore. Tax Ct. Sept. 9, 2015\)](#).

Background

Prior to 1989, two separate Oregon statutes, ORS 314.655, Oregon's codification of the Multistate Tax Compact, and ORS 314.650, Oregon's adoption of UDITPA, mandated use of an evenly-weighted three-factor apportionment formula. In 1989, the Oregon legislature amended the UDITPA formula to provide for double-weighting of the sales factor, but did not revise the Compact formula. The legislature subsequently amended the statute several more times, providing for 80 percent sales factor weighting in 2001, and finally moving to a single sales factor in 2005. In 1993, the Oregon legislature enacted ORS 314.606, which provides that "in any case in which the provisions of ORS 314.605 to 314.675 (Oregon's enactment of UDITPA) are inconsistent with the provisions of ORS 305.655 (the Compact), the provisions of ORS 314.605 to 314.675 shall control." ORS 314.606 thus mandated that the single-sales factor apportionment formula adopted in 2005 be utilized in lieu of the evenly-weighted three-factor Compact formula.

The taxpayer, Health Net, was engaged in the delivery of managed health care services throughout the U.S. On its original returns, the taxpayer utilized the single-sales factor apportionment formula. However, following a federal audit, the taxpayer filed amended returns/claims for refund utilizing the equally-weighted three-factor formula set forth in ORS 305.655. After the Department of Revenue denied the taxpayer's requested refunds, the matter came before the Oregon Tax Court.

Oregon Tax Court Decision

The following six questions were before the tax court to resolve whether the taxpayer was allowed to utilize the Compact's provisions in apportioning its income to Oregon.

- (1) What was the effect of the 1993 law providing that the UDITPA formula prevailed over the Multistate Tax Compact formula?

- (2) Did the legislative process employed in adopting ORS 314.606 violate the Oregon Constitution Full Text provision?
- (3) Did the Oregon legislature violate the Oregon Contract Clause when it enacted ORS 314.606?
- (4) Did the Oregon legislature violate federal law when it enacted ORS 314.606?
- (5) Did the Oregon legislature violate the Federal Contract Clause when it enacted ORS 314.606?
- (6) Did the Oregon legislature violate the Compact Clause of the United States Constitution when it enacted ORS 314.606?

What is the effect of the 1993 law providing that the UDITPA formula prevailed over the Multistate Tax Compact formula?

Because courts typically address state statutory questions before state and federal constitutional issues, the court first addressed whether, in adopting ORS 314.606 in 1993, the Oregon legislature effectively disabled the Compact election. After reviewing the language and legislative history of ORS 314.606, the court agreed with the Department's view that the legislature intended to effectively disable the Compact election when it enacted ORS 314.606. Testimony by Department of Revenue personnel and the Legislative Revenue Office at multiple committee meetings in 1993 established that the legislature intended that the Compact election to be disabled.

Did the enactment of ORS 314.606 violate Oregon's Full Text provision?

The Full Text provision states that "no act shall ever be revised, or amended by mere reference to its title, but the act revised, or section amended shall be set forth, and published at full length." In the court's view, the adoption of ORS 314.606 did not purport to amend the Compact; rather, it provided a tie-breaker for inconsistencies between UDITPA and the Compact. Thus, it was an independent, complete law that did not repeal the Compact election, but, rather, effectively disabled the election.

Did Oregon legislature violate the Oregon Contract Clause when it enacted ORS 314.606?

The Oregon Contract Clause provides that "no law impairing the obligation of contracts shall ever be passed." Health Net argued that the by adopting the Compact, the legislature created a statutory contract, the obligations of which were impaired by ORS 314.606. After reviewing contract law, the terms of the Compact, and the member states' course of conduct, the court concluded that no contract was formed when the member states adopted the Compact. The provisions of the Compact and the ability to withdraw at any time indicated that the member states did not intend to make promises to one another enforceable by law. Further, the provisions of the Compact did not clearly and unambiguously indicate an intention to bind the future legislatures of the member states. In the court's view, "[a]ny doubt as to these conclusions is removed when the actions of the member states in amending the Compact and disabling Compact terms" without consequence or objection are considered.

Did the Oregon legislature violate federal law when it enacted ORS 314.606?

The court, noting that the taxpayer had not identified a federal statute that was implicated, concluded that the Compact, not having been approved by Congress, did not have the status of a federal law.

Did the Oregon legislature violate the Federal Contract Clause when it enacted ORS 314.606?

Having determined that no contract existed under Oregon law, the court ruled there could likewise be no impairment of contracts for purposes of the Federal Contract Clause. Furthermore, even if the Oregon legislature were considered to have entered into a contract when it adopted the Compact, the limitation on the state's ability to alter the contract must be applied as interpreted by the U.S. Supreme Court in *El Paso v. Simmons*. In that case, the U.S. Supreme Court held that no party should be subject to "unforeseen advantages or burdens." The party claiming the benefit of a contract must be limited to "gains reasonably expected." The taxpayer's interpretation, the court observed, would subject it to unforeseen advantages in light of the many changes that have occurred in state apportionment since the time Oregon adopted the Compact. The Court's opinion at this point contains a rather dramatic review of state apportionment since *Moorman*, essentially arguing that everyone should have known what would transpire once the U.S. Supreme Court upheld Iowa's apportionment single-sales factor apportionment.

Did the Oregon legislature violate the Compact Clause of the United States Constitution when it enacted ORS 314.606?

The Compact Clause of the U.S. Constitution provides that "no State shall, without the Consent of Congress [...] enter into any Agreement or Compact with another State." The court noted that certain types of interstate compacts—those that may encroach or interfere with the supremacy of the United States—must be approved by Congress. Once congressional consent is given, the interstate compact becomes a federal law that is binding on the states. In situations where no congressional consent is given, no federal law is created. Further, if a state legislature has not bound itself and future legislatures in a statutory contract, the label of "compact" does not magically supply consideration or clear and unambiguous terms to create a statutory contract.

The taxpayer cited to a number of authorities as support for its position that, under the Compact Clause, an independent limitation on state legislatures exists when Congress has never approved or needed to approve the underlying compact. However, after an extensive review of the cases presented, the court determined that:

Notwithstanding general statements found in cases and often repeated, there is simply no authority for the proposition that under the Compact Clause, an independent limitation on state legislatures exists when no approval by Congress was necessary or given... The label "compact" does not have a talismanic power to create a substantive limitation on the actions of state legislatures.

Next Steps

The Oregon Tax Court concluded that the adoption of ORS 314.606 was intended to disable the Compact election, and that such action did not violate any procedural or substantive provision of the Oregon Constitution. Neither did it violate any provision of federal statutory law, the federal Compact Clause, or federal Contract Clause. As such, the taxpayer was not entitled to elect the Compact in determining its Oregon corporate excise for the tax years at issue. It remains to be seen whether Health Net will appeal to the Oregon Supreme Court.

This is the third taxpayer loss in a Compact election case since June. It is important to keep in mind, however, that the analysis in each of these cases is slightly different because each state adopted and/or attempted to modify the Compact in a different manner. The next decision will likely be the California Supreme Court's opinion in *Gillette*, as oral arguments in that case will be held on October 6, 2015.

For more information on *Health Net, Inc. v. Oregon Dep't of Revenue*, please contact [Rob Passmore](#) at (503) 820-6844 or [Chris Canale](#) at (503) 820-6862.

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