OREGON STATE BAR

Taxation Section

VOLUME 11, NUMBER 2 FALL 2008

In This Issue:

Previous newsletters are posted on the Taxation Section website.

Oregon Adopts Its Own Version of FIRPTA

*By Eric Kodesch**

ORS 314.258,[1] which was adopted in the 2007 regular legislative session and amended in the 2008 special legislative session,[2] imposes an income tax withholding requirement for conveyances of Oregon real property by nonresident individuals and certain foreign corporations. Although the notion of requiring that income tax be withheld upon the sale of real property by a person that otherwise generally is not subject to tax in the jurisdiction is straightforward and commonplace, the mechanics of ORS 314.258 are nuanced. Adding to this complexity, the legislature imposed the burden of complying on the professionals assisting with the transaction, rather than the parties to the transaction. This makes understanding ORS 314.258 by those engaged in facilitating real estate transactions all the more important.

Transfers of Real Property Subject to ORS 314.258

ORS 314.258 applies only to certain types of transfers of real property, by a specified group of persons. Further, even if a transaction involves the type of transfer and the type of transferor generally subject to ORS 314.258, the transaction nonetheless may be exempt from withholding.

ORS 314.258 applies only with respect to a "conveyance," which is defined as "a transfer or contract to transfer fee title to any real estate located in the State of Oregon."[3] Accordingly, there is no withholding requirement with respect to transfers of something other than fee title, such as a leasehold interest.[4] Further, withholding applies only to transfers of real estate, and there is no longer an attempt to use a broad definition akin to the federal definition of a "United States real property interest" applicable for federal withholding pursuant to the Foreign Investment in Real Property Act of 1980 ("FIRPTA").[5] Finally, withholding applies to consideration paid, net proceeds received, or gain recognized.[6] Accordingly, withholding does not apply to transactions in which no amount is paid or the transferor does not recognize gain (*e.g.,* a gift).

In addition, withholding applies only if the transferor, as of the date of the closing, is a nonresident individual or a C corporation that is neither domiciled in Oregon nor qualified to do business in Oregon.[7] This indicates that withholding does not apply to other entity transferors (*e.g.,* an estate, a trust, a partnership, or an S corporation). Recently adopted temporary administrative rules confirm this interpretation.[8]

Exemptions to Withholding

Even if the transfer involves a conveyance and a transferor subject to withholding, an exemption may apply to make withholding unnecessary. Namely, withholding does not apply if any of the following is true:

"(a) The consideration for the conveyance does not exceed $100,000;

"(b) The conveyance is pursuant to a judicial foreclosure proceeding, a writ of execution, a nonjudicial foreclosure of a trust deed or a nonjudicial forfeiture of a land sale contract;

"(c) The conveyance is in lieu of foreclosure of a mortgage, trust deed or other security instrument or a land sale contract with no additional monetary consideration;

continued next page

"(d) The transferor is a personal representative, executor, conservator, bankruptcy trustee or other person acting under judicial review;

"(e) The transferor delivers to the authorized agent a written assurance as provided in [IRC §] 6045(e) * * * that the sale or exchange qualifies for exclusion of gain under [IRC § 121];

"(f) The authorized agent obtains a written affirmation that the transferor is unlikely to owe Oregon income tax as a result of the conveyance;

"(g) The amount that would be withheld * * * is less than $100, or less than a minimum amount established by rule by the Department of Revenue; * * *."[9]

Most of these exemptions are self-explanatory. Items (e) and (f), however, require further explanation.

Generally, IRC § 6045(e)(1) requires a so-called "real estate reporting person" to file a return with respect to a transaction involving the sale of real estate. This filing is not necessary, however, for the sale of a residence if the real estate reporting person receives a written assurance as to certain facts, including that *all* of the gain from the sale is excludible from gross income pursuant to IRC § 121.[10] Accordingly, the ORS 314.258(e) exemption applies only if *all* of the gain from the conveyance is excluded from income pursuant to IRC § 121.[11]

The exemption related to the "written affirmation" is ambiguous, with the only specific guidance provided being that the written affirmation must be a statement signed under penalties of perjury by the transferor or the transferor's tax advisor.[12] Before the changes made in the 2008 special session, a similar exemption applied if the transferor had

"professionally competent knowledge or advice that the transferor will not owe tax under ORS chapter 316, 317 or 318 for the tax year because the conveyance is an exchange that qualifies for deferral under section 1031 or 1033 of the Internal Revenue Code or is a nontaxable transaction under Oregon tax law."[13]

Accordingly, the Oregon legislature has lessened the transferor's burden with respect to this exemption by changing the standard from professionally competent knowledge or advice that a nonrecognition provision *will apply* to an affirmation that an exemption *likely applies*. The extent of this reduced burden, however, is unclear. For example, there does not appear to be a standard prescribing the factual basis, if any, for the affirmation (*e.g.,* knowledge, reasonable belief, etc.). In addition, it is unclear what level of probability will be considered "unlikely." Potentially, a less than 50 percent probability of taxation is unlikely. Whether a lower probability is required, or a higher probability could be relied on, however, is unclear. The legislature deferred to the Department for resolving these issues.[14] The Department restated the "likely" standard, without defining its meaning."[15]

Person Required to Withhold

The requirement to withhold falls on "[a]n authorized agent providing closing and settlement services in a conveyance."[16] The definition of a "conveyance" is described above. "Authorized agent" has the somewhat tautological definition of "an agent who is responsible for closing and settlement services in a conveyance."[17] The Department has clarified this definition by providing that authorized agent "does not include an employee of a transferee who merely makes payments to a transferor in connection with a conveyance ."[18] "Closing and settlement services" is defined as:

"services that are provided by:

"(A) A licensed escrow agent in a real estate closing escrow as provided in ORS 696.505 to 696.590; or

"(B) An attorney for the benefit of a transferor or a transferee in a conveyance, if, simultaneously with the conveyance, the attorney deposits the unpaid purchase price into the attorney's client trust account for disbursal pursuant to the written instructions of, or the agreement between, the transferor and transferee."[19]

The Department has clarified that these services do not include "services such as inspections, appraisals, drafting services, and recording services performed for the benefit of a transferor or transferee in a conveyance."[20] Although an attorney can be an authorized agent, an attorney is exempt from any withholding requirement if "a licensed escrow agent is providing services in the conveyance."[21] Accordingly, it may be advisable for an attorney to ensure the involvement of a licensed escrow agent in any transaction that may require withholding. In summary, the withholding obligation falls on the licensed escrow agent in the real estate closing. If the parties do not use a licensed escrow agent, an attorney representing the buyer or seller is required to withhold if "the attorney deposits the unpaid purchase price into the attorney's client trust account for disbursal pursuant to the written instructions [of the parties]."[22]

Amount of Withholding and Penalties for Failure to Withhold

If withholding applies, the amount to be withheld is the least of (1) 4 percent of the "consideration" for the transaction,[23] (2) the "net proceeds" to be disbursed to the transferor,[24] or (3) 8 percent of the "gain includable in the transferor's Oregon taxable income."[25] For this purpose, consideration "includes the amount of cash paid for a conveyance and the amount of any lien, mortgage, contract, indebtedness or other encumbrance existing against the property conveyed to which the property remains subject or which the purchaser agrees to pay or assume."[26] Net proceeds is defined as "the net amount to be disbursed to the transferor, prior to reduction for withholding, as shown on the transferor's settlement statement for the conveyance."[27] If gain from the conveyance is to be recognized pursuant to the installment method of accounting, the amount of the consideration and net proceeds remains the same. The gain includable in the transferor's income, however, is limited to the gain includable in the year of the conveyance.[28]

A penalty, in an amount not exceeding the greater of (i) $500 or (ii) the lesser of 10 percent of the required withholding or $2,500, applies if an authorized agent fails to undertake any necessary withholding.[29] If an authorized agent

withholds tax but fails to timely remit it, the Department can collect the tax from the authorized agent, as well as interest at the ORS 305.220 rate (in addition to the withholding).[30] To be timely, "[t]he authorized agent must send the tax withheld to the department within 20 days of the date the proceeds from the conveyance are disbursed to the transferor."[31]

Conclusion

A new withholding requirement generally applies with respect to sales of real estate by nonresident individuals and nondomiciliary C corporations. The withholding burden falls on those handling the sale proceeds (such as escrow agents), rather than the actual parties to the transaction. There are numerous exceptions and exemptions. For example, attorneys can escape any withholding obligation by using an escrow agent in the transaction. These legislative choices add complexity to the withholding requirement, and require professionals involved in real estate transactions, even more than buyers or sellers, to be aware of the rules governing withholding.

Endnotes

* Eric Kodesch is an associate at Stoel Rives LLP in Portland, Oregon. The author thanks Robert Manicke for his assistance with this article.

1 Unless otherwise indicated, references to "ORS" are to the 2007 Oregon Revised Statutes, as amended by the 2008 special legislative session; references to "OAR" are to the Oregon Administrative Rules; references to "IRC" are to the Internal Revenue Code of 1986, as amended; and references to "Department" are to the Oregon Department of Revenue.

2 The amendments are effective May 23, 2008 and apply to real estate conveyances on or after January 1, 2009. The Department deserves praise for helping to resolve ambiguities and potential issues lurking in ORS 314.258, as originally enacted. In addition, the Department should be commended for its speed in releasing and finalizing administrative rules related to ORS 314.258, as amended by the 2008 special legislative session.

3 ORS 314.258(1)(d).

4 As originally enacted, the withholding obligation applied to a broader category of transfers, including leases. See former ORS 314.258(1)(c) (2007).

5 For purposes of federal withholding related to a non-U.S. person, the IRC § 897(c) definition of a United States real property interest not only includes items traditionally considered real property (e.g., land and buildings), but also can include interests in entities that own real property and even personal property. Although as originally enacted the withholding obligation referred to the IRC § 897(c) definition, this was deleted in the 2008 amendment. See former ORS 314.258(1)(d) (2007).

6 ORS 314.258(2).

7 See ORS 314.258(1)(f).

8 See OAR 150 314.258(2)(a)(F) (providing that no withholding is required if "[t]he transferor is an estate, certain trusts, S corporation, general partnership, or limited partnership, or a limited liability company that [either is taxable as a partnership or is disregarded from an owner not subject to the withholding rules]"); see also OAR 150 314.258(2)(a)(G) (providing that no withholding is required if "[t]he transferor is an agency or instrumentality of the United States or the State of Oregon or is a city, county, or other municipal or public corporation").

9 ORS 314.258(3).

10 See IRC § 6045(e). Generally, provided that certain requirements are satisfied, IRC § 121 excludes up to $250,000 ($500,000 in the case of a married couple filing a joint return) of gain from the sale of a primary residence.

11 This appears to clarify the IRC § 121 related exemption as described by the Department in Oregon Form 40 WE, Affirmation of Exemption from Withholding on an Oregon Real Property Conveyance, which indicates that the exemption may be available even if the gain recognized from the sale exceeds the IRC § 121 exclusion.

12 ORS 314.258(4)(g).

13 Former ORS 314.258(3)(a)(C)(iii) (2007).

14 See ORS 314.258(4)(g) ("The department shall prescribe by rule the form and content of the written affirmation and procedures for submission to the department of the information contained in the written affirmation.").

15 See OAR 150 314.258(2)(a)(I) ("The transferor or the transferor's tax advisor executes a written affirmation under penalty of perjury that the conveyance is not likely to be taxable to the transferor under Oregon law during the tax year of the transferor in which the conveyance occurs" (emphasis added)).

16 ORS 314.258(2).

17 ORS 314.258(1)(a).

18 OAR 150 314.258(1)(a).

19 ORS 314.258(1)(b).

20 OAR 150 314.258(1)(a).

21 ORS 314.258(3)(h).

22 ORS 314.258(1)(b).

23 ORS 314.258(2)(a).

24 ORS 314.258(2)(b).

25 ORS 314.258(2)(c).

26 ORS 314.258(1)(c).

27 ORS 314.258(1)(e).

28 See OAR 150 314.258(3)(d). It appears that withholding would not apply as the transferee makes installment payments in subsequent years.

29 ORS 314.258(4)(c).

30 ORS 314.258(4)(b).

31 OAR 150 314.258(2)(b).

Pro Bono Opportunities for Tax Attorneys

How can tax attorneys help low-income clients?

Many low-income Oregonians experience tax problems every year but are unable to get assistance in resolving them. Legal Aid Services of Oregon and Catholic Charities El Programa Hispano coordinate a pro bono project through which tax attorneys can help low-income taxpayers. Several tax section members have already volunteered to accept pro bono referrals but more are needed. There is no time commitment or minimum case commitment required to participate in the program. Pro bono attorneys who would like to participate in a referral listserv will receive occasional emails describing potential cases.

continued next page

Attorneys can volunteer for any cases that interest them. Cases can also be referred in other ways to attorneys who prefer not to participate in the listserv.

What kinds of cases will be referred?

Typical issues involve dependent exemptions, filing status, earned income and child tax credits, cancellation of debt income and self-employment income. Taxpayers may need assistance with offers in compromise, installment agreements, collections due process hearings, lien and levy issues, innocent or injured spouse claims, penalty waivers or tax court representation. Some taxpayers will need assistance with state tax issues.

What are the unique benefits of doing pro bono work with this project?

These tax cases offer a unique opportunity for business lawyers to apply their specialized skills in a pro bono context. They can also help newer attorneys build legal skills and client relations skills. With current resources, legal aid organizations in Oregon are serving less than 20% of the need for legal assistance among low-income clients. Pro bono attorneys help legal aid fill this gap.

How can I volunteer?

This program is sponsored by Legal Aid Services of Oregon and Catholic Charities El Programa Hispano. Both organizations receive a grant from the IRS to represent low-income taxpayers in tax controversies and to educate English-as-a-second-language taxpayers about their tax rights and responsibilities. To volunteer or for more information, please contact Janice Morgan at Legal Aid, 503-640-8228 x 109, janice.morgan@lasoregon.org.

What You Should Know About Property Taxes in Oregon

By Christopher K. Robinson

This article provides basic information about Oregon's property tax system, and is intended to identify property tax issues that may arise for your clients.

1. The Basics of Oregon Property Taxation

The property tax year is from July 1 through June 30, ORS 308.007(1)(c), although property is generally taxable and assessed as of the preceding January 1 (sometimes known as the "assessment date"). ORS 308.210(1). Thus, for example, the value on January 1, 2008, will be used to determine the property taxes for the year beginning July 1, 2008, and ending June 30, 2009. The tax bill for the year beginning July 1, 2008, will be mailed in the fall of 2008 and will be due on November 15, 2008.

Oregon's procedures for property tax assessment and taxation were overhauled by a constitutional amendment approved by the voters in 1997, known as "Measure 50." Or. Const., Art. XI, §11. Under Measure 50, actual property taxes are based on a rate system. Each governmental taxing district has a permanent tax rate. Any local option levies and general obligations bonds that have been approved by the voters and qualifying special assessments are added to the rate. Implicit in the calculation of MAV (defined below) is a limitation on the rate of growth of a property's taxable or assessed value. The MAV for each property in existence in the 1997-98 tax year became 90% of the assessed value on the roll for the 1995-96 tax year. Or. Const., Art. XI, §11(1)(a). For subsequent years, increases in MAV are limited to 3% per year, subject to certain exceptions. Or. Const., Art. XI, §11(1)(b). *See also* ORS 308.146.

Measure 50 Oregon moved from an *ad valorem* tax base (*i.e.*, pegged to the property's current value) to a computed tax base in which current value is only one, and not necessarily the most important, component in the computation of the base for property taxation. The taxable basis for each property is calculated annually, and is typically a function of three different values: (1) real market value (RMV), what an informed and willing buyer in an arm's-length transaction will pay for that property in the open market place as of the assessment date (ORS 308.205); (2) maximum assessed value (MAV), the greater of 103% of the prior year's assessed value or 100% of the prior year's MAV, subject to certain exceptions (ORS 308.146(1)); and (3) assessed value (AV), the value on which property taxes are based, which is the lesser of RMV or MAV (ORS 308.146(2)). For some properties, a fourth value, the specially assessed value (SAV), comes into play. ORS 307.032.

Oregon property taxes are also subject to another Constitutional amendment approved by voters in 1990, known as "Measure 5." Or. Const., Art. XI, §11b. Under Measure 5, the amount of property taxes collected from each property tax account cannot exceed $10 per $1,000 of RMV for general government services, and $5 per $1,000 of RMV for education services. In counties where the tax rate is high, such as Multnomah County, a successful appeal that results in the reduction of RMV but not AV can still generate a tax refund if the reduction requires the taxes to be lowered to comply with Measure 5.

2. The Appeal Process

The typical appeal process starts by filing a petition with the local county Board of Property Tax Appeals (BOPTA) challenging the current year RMV, MAV, SAV, or AV. ORS 309.100, ORS 309.026(2). Only the property owner or other person obligated to pay the taxes on that property can appeal to BOPTA. ORS 309.100(1). For industrial property appraised by the

Department of Revenue (DOR), taxpayers can file their appeal with either the Magistrate Division of the Oregon Tax Court (Magistrate Division) or BOPTA; the same filing deadline applies to both. ORS 305.403. BOPTA cannot increase the overall value of a property. OAR 150-309.026(2)-(A).

Most appeals will involve the RMV. Taxpayers must present evidence about the market value of their property as of the January 1 assessment date. That evidence might be sales of comparable properties, or an appraisal done by an independent appraiser. Income and expense data may be relevant to commercial properties. The taxpayer's burden of proof is a preponderance of the evidence. Taxpayers generally benefit by providing BOPTA and the assessor with their evidence before the hearing. BOPTA will notify the taxpayer in writing of its decision. ORS 309.110(1). If not satisfied with the decision, the taxpayer can appeal to the Magistrate Division. ORS 309.110(7).

The Oregon Tax Court has the exclusive jurisdiction to hear tax appeals, including property tax, personal income tax, corporate excise tax, timber tax, cigarette tax, local budget law, and property tax limitations. ORS 305.410. The Tax Court has two divisions, the Regular Division and the slightly less-formal Magistrate Division. ORS 305.404.

Generally, appeals are filed with the Magistrate Division by a taxpayer who disagrees with an action by the DOR, BOPTA, a county assessor, or other government body. Cases are heard by a magistrate, who is a judicial officer sworn to apply the laws in a fair and impartial manner. ORS 305.498(4)(a). The Magistrate Division offers and encourages mediation services, which can be a cost-effective way to resolve a tax appeal. Mediation must be agreed to by all parties. Absent a settlement, the magistrate will hold a trial. Evidence must be exchanged in accordance with court rules. The magistrate's decision is based only on the parties' written and oral evidence. No official transcript or recording of the proceeding is maintained. ORS 305.430(1). Magistrate decisions can be appealed to the Regular Division. ORS 305.501(5)(a), (d).

Cases at the Regular Division are heard by a judge elected by the voters. ORS 305.452. All proceedings are original proceedings heard *de novo*. ORS 305.425. The judge's decision is based on the written and oral evidence the parties provide; again, evidence must be properly exchanged according to court rules. The Regular Division is a court of record, ORS 305.405(1), and its decisions can be appealed to the Oregon Supreme Court. ORS 305.445. The scope of review at the Supreme Court is limited to errors, questions of law, and lack of substantial evidence in the record to support the Regular Division decision. *Id.*

3. Important Deadlines

BOPTA appeals must be filed between October 25 and December 31 of the tax year being appealed. ORS 309.100(2). Appeals of BOPTA decisions must be filed with the Magistrate Division within 30 days (not one month) from the date of mailing of the BOPTA order. ORS 309.110(7). *See also* ORS 305.280(4). The taxpayer has 60 days (not two months) from the date of a Magistrate Division decision to file an appeal in the Regular Division. ORS 305.501(5)(a). The taxpayer generally has 90 days (not three months) after the occurrence of an act, omission, order, or determination of the DOR, a county assessor, or a tax collector to file an appeal in the Magistrate Division. ORS 305.280(1). An appeal to the Oregon Supreme Court must be filed within 30 days (not one month) of the date of the decision of the Regular Division. ORS 305.445.

The deadline to file most special assessment and exemption applications is April 1. *See, e.g.*, ORS 307.162(1). Many of those have no grace period for late filing, so missing this deadline can have significant consequences. If an appeal is mailed or sent by carrier, the postmark or other record of transmittal determines the date it was filed. ORS 305.820(1)(a). If filed by electronic means, the date filed is the date it is received by the reviewing body. ORS 305.820(1)(b). It is strongly advised to file appeals via a method that affords a definitive, competent record of transmittal (*e.g.*, certified mail); if the appeal becomes lost, that record will determine whether the appeal is timely. ORS 305.820(1)(c). If a filing deadline falls on a Saturday, Sunday, or legal holiday, the deadline moves to the next business day. ORS 305.820(2).

4. Exception Value

New construction, major improvement of an existing structure, omitted property added to the tax roll, and subdivision, partition, or rezoning of property are examples of exceptions that might increase MAV by more than 3%. ORS 308.146(3). The value attributed to these changes is known as the "exception value." The MAV for exception value is computed by multiplying the RMV of the property by the changed property ratio. *See* ORS 308.153, ORS 308.156. The changed property ratio is determined county-wide by dividing the average MAV by the average RMV for the same area and property class of unchanged property (*i.e.*, property with no exception value). OAR 150-308.156.

Once MAV is set, it can not be changed. It is extremely important to determine whether the exception value is correct and, if not, to file a timely appeal because, as noted above, MAV is a factor in determining assessed value throughout the life of a property and MAV is established or changed when exception value is at issue. The deadline to appeal depends on the exception event. For example, an omitted property assessment has a 90-day window of appeal, whereas new construction should be appealed to the BOPTA by December 31.

5. Exemptions and Special Assessment

There are more than 60 different exemptions and/or special assessments. *See, e.g.*, ORS chapter 307. An exemption excludes a property from taxation, either in whole or in part. Specially assessed properties are valued using an assessment technique that results in a lower value than under the usual assessment techniques. *See, e.g.,* ORS 308.701, et seq.

Most exemptions are conferred on nonprofit organizations such as those organized and operated for religious, fraternal, literary, benevolent, or charitable purposes. ORS 307.130. Properties subject to government restrictions on use, such as

continued next page

affordable housing projects, are another example of specially-assessed properties. ORS 308.701. Others include historic (ORS 358.505), enterprise zone (ORS 285C.175), and open space (ORS 308A.315) properties.

The "construction exemption" cancels the assessment on commercial facilities under construction. ORS 307.330, et seq. To qualify, the property must be new construction or an addition to an existing structure made for the production of income. ORS 307.330(1), (1)(d). Modification of an existing property from one use to another (*e.g.*, retail to office) can qualify. OAR 150-307.330(1)(b). Construction of condominiums can also qualify even though the production of income (*i.e.*, gain on sale) is a one-time event. *North Harbour Corp. v. Dept. of Rev.,* 16 OTR 91 (2002). Machinery and equipment on the construction site that is or will be installed in or attached to the building may also qualify. ORS 307.330(2).

The property must be in the process of construction on January 1, and not in use or occupancy prior to that date. ORS 307.330(1)(a), (b). Construction must be expected to take at least one year from commencement, ORS 307.330(1)(3), which occurs when work has begun or the foundation is partially or wholly laid. OAR 150-307.330(2)(a). Site preparation is not considered part of construction. OAR 150-307.330(1)(a). If construction might take more than one year, it is worth filing for the construction exemption, as there is no grace period for late filing. ORS 307.340(1). If construction takes less than one year, the taxpayer has lost nothing.

In any case, a taxpayer must file a construction exemption application by April 1 of each tax year in which the exemption is sought. ORS 307.340(1).

6. Relief for Late Filing

Under limited circumstances, the DOR or the Magistrate Division may be able to hear an appeal even if the taxpayer misses the December 31 deadline for filing with the BOPTA.

Under the DOR's supervisory power, taxpayers may file an appeal with the DOR for the current tax year and the prior two years, even if they did not timely appeal to the BOPTA. ORS 306.115(3). For example, on June 30, 2008, a taxpayer can file an appeal for the 2005-06, 2006-07, and 2007-08 tax years. (Remember that the tax year runs from July 1 to June 30.) Relief under the DOR's supervisory power is limited. The DOR may correct a value when (a) the assessor requests a reduction; (b) the taxpayer and the assessor agree to a change in writing; or (c) one of two standards is met – either (1) the taxpayer and the assessor agree to facts indicating an error is likely (*i.e.*, contamination that was not considered by the assessor), or (2) an error caused by extraordinary circumstance (*i.e.*, taxing nonexistent or exempt property) has resulted in the incorrect valuation of the taxpayer's property. OAR 150-306.115(6), (4). The appeal has two components. First, the DOR will hold a supervisory hearing to determine if it has jurisdiction to hear the valuation appeal. OAR 150-306.115(3). If it determines that it has jurisdiction, a second hearing will be held to determine the merits of the valuation appeal. OAR 150-306.115(3)(d). If dissatisfied with the DOR's decision, the taxpayer can appeal to the Magistrate Division. OAR 150-306.115-(C)(9)(a). The standard of review is abuse of discretion. *Kentrox v. Dept. of Rev.*, 19 OTR 91, 94 (2006), *aff'd*, 19 OTR 340 (2007).

7. Adjudicated Values (ORS 309.115)

A reduction in MAV or AV (from a successful appeal) will affect assessed values going forward. *See, e.g.*, ORS 308.146. In addition, upon final resolution of an appeal, the new RMV will be fixed for the next five years, subject to any trending or depreciation, or changes to the property. ORS 309.115. However, if another order correcting the RMV is entered for any of the next five years, it halts the first five year period and starts a new five year period reflecting the corrected value. ORS 309.115(4). Both carry-forwards are automatic.

8. Subsequent Year Appeals (ORS 308.285)

During the pendency of an appeal (and if no appeal is filed for the subsequent tax years), the taxpayer may ask the DOR to correct the rolls for the subsequent years. ORS 308.285. The request must be made by December 15 of the year in which the appeal is finally resolved or within six months of the final determination, whichever is later. *Id*.

9. Industrial Properties

The DOR is responsible for appraisal and valuation of all industrial properties in Oregon, such as electronic/high tech, wood/paper, food processing, primary and secondary metals, chemical, plastics, and printing industries. ORS 306.126; OAR 150-306.126(1)(c). A Magistrate Division appeal of a BOPTA order for industrial property should name both the county and the DOR as defendants, as valuation of the underlying land remains the responsibility of the county assessor. OAR 150-306.126(1)(g)(B). Several important issues arise in the valuation of industrial property.

A frequent focus is whether the property is "special purpose property" that is designed, equipped, and used for a particular type of operation and is not easily adaptable to other uses because of the peculiar nature of the improvements. OAR 150-308.205-(A)(3). Special purpose properties are often insufficiently similar to other properties that have sold, which prevents an appraiser from using the sales comparison method of valuation. Because it can be difficult to separate income attributable solely to the real property from that attributable to the nontaxable or intangible assets, designating a building as special purpose leaves an appraiser with only the replacement cost approach of valuation. Accordingly, the DOR will determine a value based on just compensation to the owner, resulting in a value that is often higher than real market value. *Id*. A frequent issue in these appeals is whether a property is in fact special purpose or merely general purpose with superadequacies exceeding market norms.

10. Obsolescence

Functional and economic obsolescence can be significant factors in valuing industrial properties. They are particularly important when an appraiser is relying on the cost approach,

which assumes a buyer will not pay more for an existing property than the cost to construct a replacement. The purpose of deducting obsolescence is to indicate the loss in value due to its deficiencies when compared to a possible new replacement.

Functional obsolescence is caused by a flaw that diminishes the function, utility, and value of an improvement. It deals with defects within a property. An example would be 12-foot ceilings that when built were the market standard but are now too low. Functional obsolescence can be curable or incurable. It can be caused by a deficiency, which means that the property is below market norms, or it can be caused by a superadequacy, as referenced above.

Economic obsolescence is an impairment of the utility or marketability of a property due to outside negative influences, such as adverse market conditions. Economic obsolescence can be temporary or permanent.

11. Common Property Tax Issues

In addition to the foregoing, there are some common property tax issues of which every taxpayer should be aware.

Distressed Properties

Oregon law requires that vacancy and stabilization costs be taken into account in valuing commercial properties. *Kailes v. Josephine County Assessor*, 16 OTR 48 (2001). If a property has languished on the market, a successful property tax appeal on this basis can help offset some of the carrying costs. Zoning laws, such as to the types of businesses allowed to operate in the area or the minimum or maximum size of the property, can also impact value. Defects in construction must be considered in value, as well as the stigma that can result even after defects are repaired.

Contamination

Oregon law also requires that the impact of contamination be taken into account in the valuation of property. OAR 150-308.205-(E)(3). This can mean not only contamination of the taxpayer's own property, but the stigma resulting from contamination of nearby properties – for example, a property located near a Superfund site. OAR 150-308.205-(E)(3)(a)(E).

Reporting Errors

The valuation of industrial plants, personal property, machinery, and equipment is usually based upon the cost approach. A taxpayer's reported cost is trended and depreciated based on a schedule of factors established by the DOR. Each category of assets has a floor valuation factor. So long as an asset is reported, it will continue to be taxed at the floor regardless of its real market value or the taxpayer's book value. Due to changes in market conditions the values arrived at with the DOR's schedules can become out of step with the market, resulting in appeals. Discovery of reporting errors may be grounds for correcting the current year roll value as well as the prior two tax years. An example of a reporting error would be listing property that is no longer in existence.

Conclusion

A taxpayer should never assume that his property tax valuation is correct. Most valuations are performed using mass appraisal techniques. While this works well for valuing thousands of properties in a short period of time, the nature of the process does not reflect the specific features of any one property. Moreover, mass appraisal is done by computer and errors can and do happen. Property values are not static. For example, during the last 18 months there have been significant changes in the residential sector for newly built single family residences and condominiums. This is also true for certain industries such as timber and food processing. Thus, it is important for every taxpayer to review his property taxes each year for accuracy.

Tax statements for the 2008-09 tax year will be mailed out around the third week in October. This will be an opportune time for all taxpayers to closely monitor valuations and to determine whether an appeal might provide the opportunity for significant property tax savings.

Christopher K. Robinson is a member of the Oregon State Bar who specializes in real estate and ad valorem property taxation.

Oregon Department of Revenue Adopts "Economic Presence" Standard for Determining Nexus

By Scott M. Schiefelbein[1]

In multistate taxation, invariably the threshold question is whether the state may constitutionally impose its tax regime on the taxpayer. The answer to this question hinges on whether the taxpayer has "nexus" with the state. In order to expand their taxing powers, many states including Oregon are trying to shed the historical "physical presence" nexus standard in favor of a more nebulous "economic presence" nexus standard for corporate excise and income tax purposes.

As had been expected, the Oregon Department of Revenue changed the rules of the game with the adoption of OAR 150-317.010. Under OAR 150-317.010, effective May 5, 2008 "economic presence" nexus is the Department's new standard for determining when to impose corporation excise and income taxes.

The Department's new OAR directly follows from the Oregon legislature's refusal to enact Senate Bill 177, which would have

continued next page

redefined "substantial nexus" to provide that any taxpayer with, inter alia, more than $500,000 in Oregon sales would have nexus with Oregon. Instead of the failed legislation's bright-line dollar amount test, OAR 150-317.010 adopts a facts-and-circumstances test that lacks any specific standards. As stated in the new OAR, "[s]ubstantial nexus exists where a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer and may be established through the significant economic presence of a taxpayer in the state."[2]

Among the nonexclusive factors evidencing substantial nexus under the new OAR are such taxpayer activities as conducting "deliberate marketing" to Oregon customers and receiving "significant gross receipts" from Oregon customers.[3] Neither "deliberate marketing" nor "significant gross receipts" are defined. An example included in the new OAR provides that annual gross receipts of less than $350 would not qualify as "significant."[4] The fact that $350 would not qualify as "significant" is so self-evident to this author that the example provides only scant guidance. Any single factor, including a factor not listed in the new OAR, may be sufficient to indicate substantial nexus.[5]

The new rule has substantially lowered the bar for establishing nexus with Oregon when compared with the historical physical presence nexus standard. For example, an out-of-state taxpayer who enters Oregon solely to pursue remedies in Oregon courts to protect its intellectual property rights or collect unpaid debts may thereby create nexus with Oregon.[6]

Not surprisingly, the new OAR has been criticized as overbroad and vague. However, taxpayers and practitioners should also be aware of the potential opportunity the new OAR may create for Oregon-based taxpayers who have sales thrown back to Oregon for apportionment purposes.[7] The new rule provides that Oregon must apply its economic nexus rule to determine if a taxpayer has nexus with a state other than Oregon.[8] Accordingly, this new OAR may limit the amount of sales thrown back to Oregon each year, particularly from states that have not adopted the economic presence nexus standard.

Practitioners must therefore be aware of all of the repercussions of Oregon's new economic presence nexus standard. Not only will the Department seek to impose its taxing authority on a growing number of taxpayers, there may be opportunities for taxpayers to use the new OAR to their advantage.

Endnotes

1 Scott M. Schiefelbein is a Manager working in Deloitte's Multistate Tax Practice in Portland, Oregon. Scott extends special thanks to Daniel Lapour, a Senior Associate in Deloitte's Portland office, for his assistance in preparing these materials. This article is written in general terms and is not intended to be a substitute for specific advice regarding tax, legal, accounting, investment planning, or other matters. While all reasonable care has been taken in the preparation of this article, Deloitte accepts no responsibility for any errors it may contain, whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person or entity that relies on it. Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

2 OAR 150-317.010(2).

3 OAR 150-317.010(3)(b), (d).

4 OAR 150-317.010, Example 2.

5 OAR 150-317.010(4).

6 OAR 150-317.010(3)(f)(B).

7 Generally speaking, for purposes of calculating the sales factor for an Oregon-based taxpayer, a sale that originates in Oregon but is delivered or shipped out of the state is "thrown back" to Oregon if the taxpayer is not taxable in the destination state.

8 OAR 150-317.010(5).

Presorted Standard
US Postage
PAID
Portland, Oregon
Permit No. 341

Oregon State Bar
Taxation Section
16037 SW Upper Boones Ferry Rd
PO Box 231935
Tigard, OR 97281